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BusinessWeek



DEEP TROUBLE

WHY THE COMMERCIAL REAL ESTATE CRISIS LOOKS SO SCARY

BY MARA DER HOVANESIAN & DEAN FOUST

PLUS THE SANDWICH THAT ATE THE RECESSION

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CONTENTS



IN DEPTH

THIS REAL ESTATE BUST IS DIFFERENT

042 | Commercial property prices have already fallen 41% since the market peaked in 2007. Big bets based on unrealistic assumptions, layers of investors, and possible fraud will make it especially challenging to clean up the mess. | BW |

A WAKEUP CALL FOR PART-TIME B-SCHOOLS

048 | The economic crisis has hit executive MBA and non-degree programs with punishing force. Here's what the savviest schools are doing to adapt to the harsh realities of today's market. | BW |

THE SANDWICH THAT ATE THE RECESSION

058 | As nearly every restaurant chain reeled, Subway—inspired by the success of an obscure Miami franchisee—rolled out its $5 footlong campaign. Long story short, that's why it now outshines Burger King and Wendy's in the fast-food firmament. | BW |

Jeff Moody, CEO of the Subway Franchisee Advertising Fund Trust

(COVER) ILLUSTRATION BY MIRKO ILIC; (THIS PAGE) RICHARD FREEDA/AURORA

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EDITED BY HARRY MAURER & CRISTINA LINDBLAD



The deal for Burlington Northern is Buffett's biggest ever

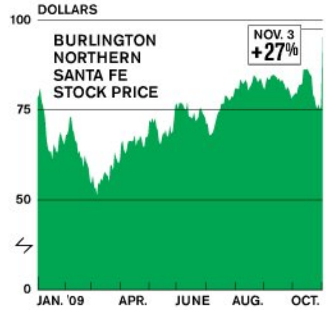
BEN BAKER/REDUX

STRATEGY

BUFFETT BAGS ONE

Berkshire Hathaway CEO Warren Buffett has hinted for a while that he was on the prowl for big game. On Nov. 3 he bagged a trophy, laying out $26 billion for all the stock he didn't already own in **Burlington Northern Santa Fe,** the No. 2 railroad by market cap in the U.S. The deal, valuing BNSF at $34 billion, is the biggest in Berkshire's history and in Buffett's words amounts to "an all-in wager on the economic future of the United States." The price represents roughly a 30% premium over BNSF's closing the day before, and Buffett will also assume $10 billion in debt. As with every Buffett move, the takeover is being parsed for signs and portents. Is he calling a bottom to the recession? Is he betting demand for goods shipped by rail is about to go up? The Oracle of Omaha recently said he had seen no real bounce at any of Berkshire's portfolio companies, though "they might be doing just a tick better" than they were six months ago.

THE BUFFETT EFFECT



Data: Bloomberg

FORD PICKS UP SPEED

It was a week of surprises from Detroit. Ford on Nov. 2 astonished investors with a $1 billion profit in the third quarter. Analysts had predicted a small loss, but $1 billion in cost cuts and $1.9 billion in price increases turbocharged the bottom line. The next day, **General Motors** reneged on a September agreement to sell a controlling stake in its money-losing German **Opel** unit. GM's board never liked the deal, but the German government wouldn't finance any other rescue plan for Opel. When Berlin said in October that it would consider other solutions, GM did a U-turn and will negotiate for $4.5 billion in state funds to help perform a turnaround.

| BW | PAGE 038 "The Engine Finally Turns Over at Ford""

MICKEY IN SHANGHAI

Score a major coup for **Walt Disney CEO Robert Iger**—even if it has only taken about 15 years since Shanghai brought the idea to Disney. On Nov. 3 Iger announced that Beijing has finally O.K.'d the $3.6 billion theme park that Disney and the Shanghai municipal government aim to open as early as 2014. Disney would hold a 43% stake, giving it access to the 300 million people who live within a day's travel of the city. Just as important, it would gain a bigger beachhead in the vast Chinese market for its film, merchandise, and TV businesses.

J&J'S HEADACHE CURE

The recession is inflicting pain on the world's top manufacturer

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of health products, so **Johnson & Johnson** is reaching for a tried-and-true remedy: layoffs. On Nov. 3 the company said it would pare 7% of its global workforce, between 7,000 and 8,000 people, which will save more than $1.4 billion a year starting in 2011. **CEO William Weldon** told analysts his goal was to slash layers of management across all of J&J's units, not just to save money but also to streamline the process for getting innovative products to market. J&J could use some new hits: Its two top drugs, **Risperdal** and **Topamax,** which together racked up $7 billion in annual sales, went generic over the past year.

"Johnson & Johnson to Overhaul Pharma, Cut 7,000 Jobs"
businessweek.com/magazine

ECONOMICS & POLICY

THE FED SPEAKS

Gold may be over $1,000 an ounce and oil back up to $80 a barrel, but the **Federal Reserve** is determined not to react too quickly to contain inflation. It's worried that raising rates now might choke off the fragile recovery. So on Nov. 4 the rate-setting **Federal Open Market Committee** stood its ground again, vowing to keep rates at a rock-bottom zero to 0.25% "for an extended period."

"The Fed's Potent Medicine"
businessweek.com/magazine

BRITISH BAILOUTS

Just when you thought bank rescues were a thing of the past, the Brits are at it again. On Nov. 3 the government



At Disney's Hong Kong theme park: China gave the go-ahead for one in Shanghai

ANDREW WONG/GETTY IMAGES

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RBS CEO Stephen Hester: The bank got $41.8 billion more in public money

injected $51 billion more into ailing **Lloyds Banking Group** and **Royal Bank of Scotland.** RBS will pocket 80% of the cash, or $41.8 billion, which will boost taxpayers' ownership of the once-mighty lender to 84%. Lloyds' handout totals $9.3 billion, with the bank expecting to raise an additional $24.9 billion in the capital and bond markets. As part of the deal, both banks will have to sell assets, including mortgage and trading businesses, and won't pay bonuses to those earning more than $64,000.

"European Commission Forces UK Banking Shakeup" businessweek.com/magazine

BLOOMBERG'S THIN WIN

Michael Bloomberg won his first two elections as mayor of New York largely on a platform of competence. As the billionaire founder of financial data provider **Bloomberg LP** (soon to be the owner of *BusinessWeek*), he argued that he could skillfully and honestly run the nation's largest city. In his third run at the job, voters proved lukewarm and gave him a much narrower victory than in 2005. After spending $90 million of his own money in the campaign, Bloomberg defeated Democratic challenger **William Thompson** by 51% to 46%. It was a day for comeuppances: The GOP lost a congressional seat it had held since 1872 in an upstate New York district but won the governorships of New Jersey and Virginia. The Republican wins should reinvigorate the party and fortify its opposition to **President Barack Obama** as it builds momentum toward next

8.4%

Revised 2009 GDP growth forecast for China, up from 7.2% earlier in the year

Data: World Bank

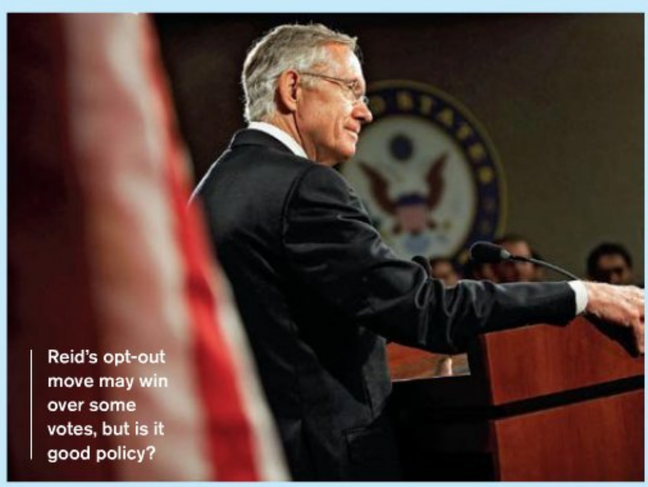
IDEAS HEALTH REFORM: 'OPT-OUT' MAY PROVE UNHEALTHY

From a political standpoint, at least, the opt-out looks like a stroke of genius. **Senate Majority Leader Harry Reid's** decision to include an exit clause in the Senate version of health-care reform may help secure critical votes for the controversial public option. States that don't relish a government-run insurer can simply decline to take part.

The opt-out is also consistent with America's brand of federalism, which allows states to set their own rules in areas such as education, welfare, and yes, insurance. But **Darrell West,** director of governance studies at **The Brookings Institution,** a Washington think tank, argues that the opt-out is a lousy idea. For one, it will complicate the implementation of reform. Will the opt out-decision be left to state legislatures or put to public referendums? Will states that embrace the public option have to impose residency requirements in order to discourage unhealthy folks from opt-out states from gaming the system? That's what happened after welfare reform.

West also believes that the opt-out makes for bad precedent. What about climate-change legislation—will some states demand that the final bill also include an escape hatch? If the opt-out had been available back in 1965, he argues, it's conceivable that one-third of the country would have ended up without **Medicare.**

The Brookings Institution



Reid's opt-out move may win over some votes, but is it good policy?

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008 EXECUTIVE SUMMARY



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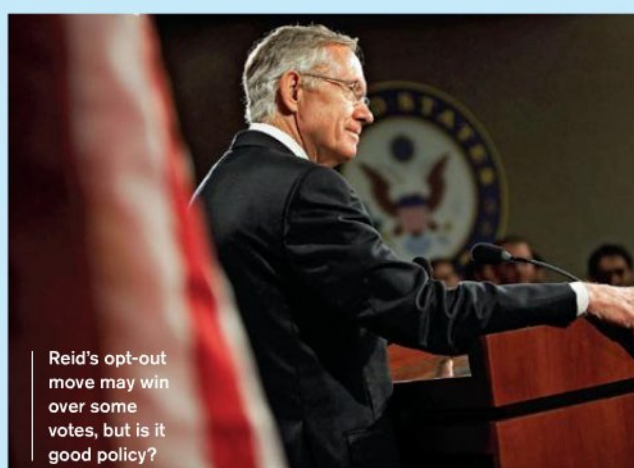
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Delegates from the 28 listed companies posed at ChiNext's opening

November's midterm national elections.

FINANCE

CHAPTER 11 FOR CIT

After countless suspenseful twists and turns, the CIT soap opera is winding down. The commercial lender filed for bankruptcy on Nov. 1 in a prepackaged plan that could see it emerge from Chapter 11 in as little as a month. The deal was backed by holders of about 75% of CIT's debt, which will be trimmed by $10 billion. Even unhappy lender **Carl Icahn** buried the hatchet and agreed to provide a $1 billion revolving credit line. Creditors are expected to receive new notes worth 70¢ on the dollar, plus common stock.

A WILD RIDE IN CHINA

As if China's regular stock markets weren't scary enough, the newest roller coaster opened on Oct. 30 in Shenzhen: **ChiNext,** the country's answer to **Nasdaq.** By the end of the day most of the 28 listed companies had rocketed to triple-digit gains from their IPO prices as retail speculators piled in. But hold on tight: The second day of trading saw 25 stocks fall, their descent checked only by the 10% downside circuit breakers. And most stocks kept plunging on the third day.

"Casino Trading: China's Nasdaq-Style Exchange Opens" businessweek.com/magazine

TECHNOLOGY

CUOMO FIRES AT INTEL

Joining the parade of litigants against Intel, **New York Attorney General Andrew Cuomo** on Nov. 4 accused the chip behemoth of a "systematic campaign of illegal conduct" intended to discourage if not prevent PC makers such as **Dell** and **Hewlett-Packard** from using **Advanced Micro Devices** chips. AMD's federal antitrust lawsuit against Intel is scheduled for trial in March, and Intel is appealing a $1.45 billion fine by the **European Union.** An Intel spokesman said there's nothing new in Cuomo's complaint and promised that the company will defend itself.

LEADERSHIP

RUIZ BOWS OUT

An insider-trading case has turned a former **Advanced Micro Devices** chieftain into an outsider. **Hector Ruiz** stepped down on Nov. 2 as chairman of **GlobalFoundries,** the chipmaking arm of AMD and **Advanced Technology Investment** that was spun out from AMD earlier this year. Ruiz, who took a voluntary leave of absence and will quit permanently in January, has been named in media reports as the person who allegedly shared insider info on AMD's plans with a woman who funneled it to hedge fund **Galleon Group.** He has not been charged with wrongdoing. An AMD spokesman said Ruiz had already been planning to exit in early 2010.



After Ruiz was linked in an insider-trading case, he stepped down

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Find the Best Employees: Hire Veterans

Today's military is the largest technical and leadership training school in the world. Following the Vietnam War, the military eliminated the draft, reducing its active duty force from 3.8 million to today's 1.4 million. It was successfully transformed by changing its strategy to focus on education and technology.

In 1970, one in ten people working in America served in the military. Today that number has been reduced to only one in 250. There are now two generations of Americans who have had no association with the military, and thus may not appreciate or understand the capabilities that a veteran can bring to a job.

Veterans of Foreign Wars (VFW) sponsored VetJobs makes the case that a veteran:

- is educated
- has technology training
- is a disciplined and reliable worker
- is team- and mission-oriented
- has a security clearance
- has a can-do attitude and is a proven leader.

Why should a company hire veterans?

VetJobs' president, Ted Daywalt, asks: "How many executives in any company manage a $60,000,000 budget, lead 15 people, go through extensive training to learn their job, and if they make a mistake, will take the City of Jacksonville *off the face of the earth*?

That's the basic job description of a weapons officer on a Navy frigate, who also has several other duty assignments . . . and by the way, she just turned 25 years old." Corporate America needs those very qualities that veterans can bring to any job.

On this Veterans Day, make it a point to meet today's military. It's not the military of World War II, Korea or Vietnam. It is the most highly trained, technically capable, diverse, and teamwork-oriented work force in the world today.

Visit **www.vetjobs.com** to learn how to tap into this valuable employee resource.

Partner Profile: The author, Captain Ted Daywalt (USN-Ret.) is president and founder of **VetJobs**. VetJobs is a Service Disabled Veteran-Owned Small Business and an employment service delivery system for EEOC, VEVRAA/JVA, and OFCCP compliance support. It has been recognized as the leading military job board on the Internet by AIRS *Top Recruiting Site* (7-year recipient),is a four-year recipient of the *Workforce Management Top 10 Recruiting Sites*, and six-year recipient of WEDDLE's *User's Choice Award*.

Supporting the Guard & Reserve

In the transition to an all-volunteer force, the Department of Defense established Employer Support of the Guard and Reserve (ESGR) in 1972 to develop and promote a culture in which employers support and value the military service of their employees. Today, the volunteer force continues with the National Guard and Reserve making up nearly half of America's military strength.

ESGR Executive Director Polli Brunelli states, "Guard and Reserve members are poised to respond to our communities and our nation in times of need. They are proven first responders located in every community in America. Public and private sector employer support and employment of these citizen warriors are crucial to preserving a ready Reserve and National Guard."

Employers stand to gain greatly in hiring Guard and Reserve members. Service members are technically skilled, motivated, reliable and disciplined team players. As loyal, mission-oriented proven leaders, service members are ideal for any company. With ESGR's help, more employers are realizing these benefits.

ESGR's 4,700 volunteers strengthen employer and service member relationships by providing valuable education about the Uniformed Services Employment and Reemployment Rights Act (USERRA). A robust awards program that includes the Secretary of Defense Employer Support Freedom Award, rounds out ESGR's efforts to strengthen employer relationships by recognizing outstanding support.

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Keith Vaughan, Managing member of North Carolina based Womble, Carlyle, Sandridge & Rice PLLC and 2008 Freedom Award recipient, with firm Attorney and U.S. Navy Reservist Lieutenant Commander Christopher Geis

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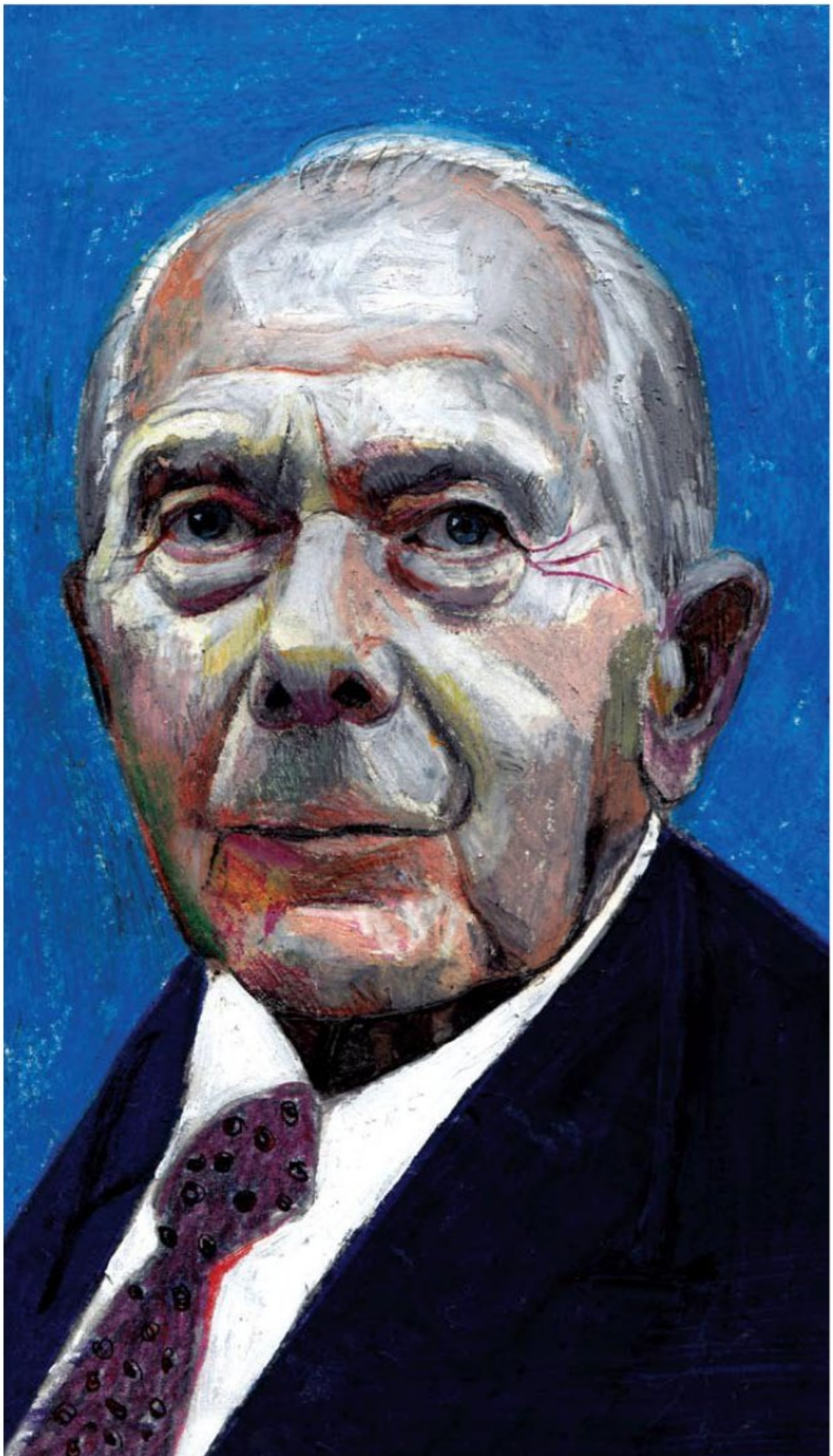
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FACETIME | MARIA BARTIROMO





(TOP) BRAD TRENT; ILLUSTRATION BY ANDREA VENTURA (BASED ON PHOTOGRAPH BY JAY PREMACK/BLOOMBERG NEWS)

THE ENDURING ANGER OF HANK GREENBERG

Hank Greenberg, who built American International Group into one of the most powerful and complex financial entities in the world, is not a man who lets go easily. Since then-New York Attorney General Eliot Spitzer forced him out as chief of AIG during an accounting scandal in 2005, Greenberg has rarely missed an opportunity to chide his multiple successors or bemoan the folly of his ouster. Last summer he paid $15 million to settle SEC charges that, on his watch, AIG had used accounting gimmicks to paint too rosy a picture of its health. But that has probably only fueled his wrath. Greenberg fumes at the government's September 2008 bailout of AIG and does not discount the persistent chatter that it had as much to do with saving Goldman Sachs, a major counterparty of AIG's, as it did with saving "the system." Now 84, Greenberg is busy building a new business as he pushes for an investigation into the decisions made by former Treasury Secretary Henry Paulson and others at the height of the financial crisis.

MARIA BARTIROMO

A *New York Times* story last week suggested that you are poaching talent from AIG and reconstructing the AIG model at your privately held firm, C.V. Starr. Is your intention to build a competitor to AIG?

MAURICE "HANK" GREENBERG

No. Look, I'm building an insurance company and an investment company. We didn't poach anybody. We hired 13 people from AIG out of the 100,000-

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plus they have. We didn't poach them; they came to us. A lot of them had left AIG previously. I know one company in Switzerland that hired 130 people from AIG.

So you're saying AIG's talent is fleeing?
That's been going on for some time.

Are the restrictions on executive compensation imposed by pay czar Ken Feinberg driving talent into your arms?
They're driving people into anybody's arms, not just mine. Anybody in the insurance business. Why would someone running an important area of the company and doing a good job stay there for the maximum of $200,000 when they can maybe make $400,000 to $600,000 someplace else?

I'm sure you've thought about this, but what if Spitzer had not forced you out as CEO of AIG in 2005? How would things have been different?
It would have been 100% different. Nothing like [what has happened] would have taken place. [AIG] would have been strong. Oh, we would have had some losses, but they would have been minuscule compared with what we've seen.

How much money would you have saved the American taxpayer?
We wouldn't, in my judgment, have had to borrow any money from the taxpayer.

"The taxpayer will never be paid back by liquidating AIG. The only way to get paid back is to rebuild the company"

What would you have done differently?
I know for a fact that [Martin] Sullivan told everybody: "Just do everything you want, get as much business as you can, and don't worry about a goddam thing." Everything they did disregarded risk management. That's not the way you run a company. And the board sat on its tail. Frank Zarb did nothing. He was the goddam chairman. What did he do?

Did he understand what was happening?
Well, he was chairman. Shouldn't he have known? What did he get paid for as chairman? Just to go to a meeting?

And if I remember correctly, the board increased their salaries.
Yes, they did. They were working so hard, they increased their salaries.

If you had still been at the helm of AIG during that black week in September 2008, and it became clear AIG needed a bailout to survive, would you have gone to the government or tapped into your connections in China and elsewhere?
I'd have done everything I could to keep the government out. Absolutely.

Since you left AIG, there have been a string of executives in charge: Sullivan, Robert Willumstad, Edward Liddy, and now Robert Benmosche. How would you rate the job Benmosche is doing?
From what I can see, he's doing a pretty good job. He's an experienced executive. He ran MetLife. I think he's a better leader. But if you can't pay reasonable compensation, I don't care how good you are.


Spitzer in 2005. If he hadn't forced out Greenberg, "it would have been 100% different"

ADAM NADEL/POLARIS

Treasury Secretary Tim Geithner was asked on *Meet the Press* on Nov. 1 if he would like to see AIG prosper. And he said: "I'd like it to be successful enough that the taxpayer can get out." After that, he said he didn't care what happened.
That's a really great statement, isn't it?

What's the government's goal here?
To liquidate the company and pay the taxpayer back. But the taxpayer will never be paid back by liquidating AIG. The only way to get paid back is to rebuild the company so it becomes viable again. Why was it decided AIG would be the sacrificial lamb?

Was it to save Goldman Sachs?
Maybe. But I think there's got to be a complete investigation of who did what and why.

How significant has this been in terms of wealth destruction for you?
Considerable. Not just for me, but for every one of the employees and executives at AIG. And how many shareholders? AIG had a market cap of $180 billion when I left. Goddam near worthless today.

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog, Maria Bartiromo's Investor Agenda, at investoragenda.cnbc.com

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SPECIAL ADVERTISING FEATURE

Building It **Green**



There is a massive social, political, and economic movement underway that is reshaping the way we build and run our homes and offices. When it comes to air, atmosphere and water, buildings in the United States create more carbon dioxide than transportation and industrial output combined: 55% of the nation's total carbon dioxide emissions come from buildings.

The numbers show great opportunity for those entering the green market. Demand is expected to grow as people become more aware of the impact their built environment has on the natural environment. It's no wonder that companies are increasingly choosing to be part of the growing green building movement –and industry–in the United States.

Cosentino, the Houston-based countertop company, recognized the move to green building and LEED certification over a decade ago. The firm is the largest manufacturer of natural quartz surfaces in the world, and covers all aspects of producing natural stone products, including quarrying, extracting, fabricating and installing flat surfaces such as kitchen and bathroom countertops, wall cladding, and flooring.

"There had been other green countertops on the market prior to ECO by Cosentino, but there were none that had the high performance and aesthetics as ECO by Cosentino does today," says Lorenzo Marquez, VP of Marketing at Cosentino. "Additionally, prior to the launch of this product, no other green countertop had the capability to mass produce and provide this countertop on such a wide scale–essentially taking green countertops from *niche to the norm*."

ECO is Cosentino's line of countertop and surfacing material composed of 75% recycled materials. The company invested $6 million in research and development to develop a cradle-to-cradle product that appeals to the environmentally conscious and design-oriented architect, designer, or consumer.

For companies like Cosentino, which just launched in 1,600 Lowe's Home Improvement stores, there are tangible first-mover advantages associated with business progressiveness. Subsequent competitors will face barriers to entry in the form of specialist know-how, which should result in a lower level of competition than in the mainstream market. Channels developed today are competitive strengths tomorrow.

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www.currentgroup.com

Business is Building

Activity in the space is becoming self-reinforcing.

In a recent survey by Turner Construction, 75% of commercial real estate executives–including developers, rental building owners, brokers, architects, engineers and others –said that the credit crunch will not discourage them from building green. In fact, 83% said they would be "extremely" or "very" likely to seek LEED certification for buildings they are planning to build within the next three years. In survey after survey, the companies and investors to whom it falls to reinforce market pull have expressed strong inclination toward building green, and by extension creating green jobs.

The act of building green has gone global, as companies in industries not normally thought of as green-focused are also working to reduce their brown footprint in an increasingly green world. At Petrobras, the largest energy producer and consumer in Brazil, energy efficiency is seen the most economical, the most effective, and the quickest solution to minimize the environmental impact brought about by the use of energy and to reduce carbon dioxide (CO_2) emissions.

The idea for all companies is, of course, to grow, which often means greater consumption of energy. But at Petrobras the idea is also to make the consumption efficient by reducing waste and losses to the environment, thereby making Petrobras' activities increasingly sustainable. That's where building green comes in: At Petrobras University, the company's corporate campus in Rio de Janeiro, a new building has been constructed to house 98 classrooms, nine specialized laboratories, 25 computer science laboratories, a restaurant, and a library...all designed and constructed in accordance with the very rigid standards of the US Green Building Council.

"In alignment with Petrobras' commitment to sustainable development, the eco-friendly corporate university campus is a benchmark in the effort to train the company's workforce," says Petrobras Shared Services Executive Manager Antonio Sergio Santana. "That also extends to the portfolio of educational projects directed towards social responsibility and environmental protection which is a part of activity at the university. We are working to tie every aspect of sustainability together in what we do, from our general operations, to the buildings we work within."

The building conforms to the most modern concepts of sustainability. All the timber used in the construction is certified, and the paints selected contain low emissions of corrosive gases. Recycled materials were used, and the water destined for the irrigation of the gardens and the flushing and cleaning of the toilets comes from the capture of rainwater and the recycling of water from the air conditioning system, which accounts for 40% of the University's daily requirements. In addition, water consumption is reduced by the use of time-controlled taps throughout the building. Steps were also taken to reduce the energy usage of the building's air conditioning system, which consumes 50 to 60% of the building's total energy load.

Engineering a Business Space

Building technology and awareness, together

In the United States, as the word 'Green' has morphed from adjective to noun to verb, 'green' buildings are being increasingly mandated by municipalities, states and the federal government. Activity in the space includes new construction, retro-engineering of 'brown' structures, and action by leaders in both government and the private sectors who have chosen to actively 'green' office buildings, residences, factories, commercial spaces and government buildings.

Technology is playing an ever-larger part in the green building space as information technology, advanced materials, and good old human ingenuity combine to create ever-more creative ways to build and manage our buildings. From architecture to engineering, product manufacturing to construction processes and building maintenance, technology is allowing the business space to expand and adapt at an unexpected, and for most quite welcome, rate.

"Now that builders and industry insiders are increasingly aware of green building products and embracing green so thoroughly, we are gradually seeing this trickle down to the consumer," says Lorenzo Marquez of Cosentino. "We are working on keeping that momentum going, educating consumers and inspiring them to incorporate green when making choices and decisions throughout all areas of their lives."

—Written by Henry Gententaar

Energy at All Levels

America's seemingly unquenchable thirst for electricity means entrepreneurial opportunity for companies working to develop a smarter grid that delivers smarter power to the nation's buildings.

Estimates are that America's energy system will need to produce 50% more power in 2025. The size of a typical American home increased 40% between 1990 and 2006, and the explosion of computers, printers, and portable electronics means power production is racing to stay ahead of—or in line with—consumption. And with power demand accounting for 40% of CO_2 emissions, the U.S. faces significant challenges for producing power cleanly and efficiently.

"We have found that by using intelligent sensing and analytics to harvest the inefficiencies of the distribution grid itself, the yield can be significant, says Ray Gogel, President and COO of Current Group. "Not only are we freeing up precious system capacity, but we are also eliminating the need for the generation of unnecessary power—even enabling utilities to monetize that asset. It's a win-win for both the environment and the consumers."

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THE FED: A WHOLE NEW PLAYBOOK FOR TIGHTENING

Now that growth is picking up, it'll soon be time to sop up excess funds. But given the unconventional easing of the past year, the old methods no longer apply

Over the past year, the Federal Reserve has committed trillions of dollars to its extraordinary effort to shore up the financial markets and prevent a severe recession from turning into a depression. By all signs, and with help from the stimulus package, it's working. Credit is flowing better, and the economy is growing again. Now comes the hard part: Unconventional easing will require unconventional tightening. The old models don't fit the task, and the consequences of a miscalculation are much greater.

Gone are the days of simply deciding when and how much to raise interest rates. This time the Fed has to wind down more than a half-dozen lending and market support programs. It must drain the nearly $1 trillion in excess reserves it has added to the system or at least neutralize their inflationary potential (chart). And policymakers now have to consider two target rates: the traditional federal funds rate on overnight borrowing between banks and a new rate, the interest the Fed pays banks on any excess funds they hold at the central bank. For all this, the past offers no road map.

Fed watchers have a general idea of what tightening will look like, but the devil is in the details—and especially the timing. The first step: to prepare the markets, via speeches or testimony by Fed Chairman Ben Bernanke and by changes in the policy committee's statement. One of the first major alterations will be in the Fed's commitment since March to keep rates at "exceptionally low levels" for "an extended period." Policymakers left that language intact after its Nov. 3-4 meeting, but at some point they will need more flexibility.

Keep in mind, though, that before starting to tighten, the Fed must stop easing. That will most likely occur when the program to buy $1.45 trillion in mortgage-backed securities and federal agency debt, a process that pumps funds into the system, comes to its expected conclusion by the end of March. Then the Fed can begin to drain the excess.

$2.2 trillion

Size of the Fed's balance sheet as of Oct. 28, up from $940 billion a little over a year ago

Data: Federal Reserve

For this, one tool the Fed plans to use is the sale of certain securities, called reverse repurchase agreements. Banks buy these securities in exchange for their excess cash, taking lendable funds out of the system. These sales will not initially involve raising the Fed's traditional target rate, now set at a range of 0% to 0.25%.

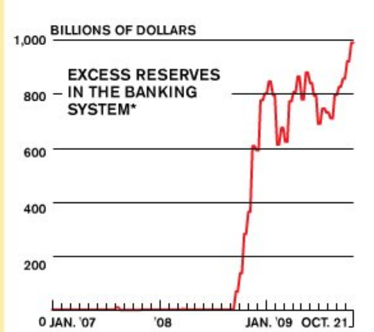
Rate increases will come in conjunction with the Fed's new authority to pay banks interest on their deposits. Manipulating this rate, now set at 0.25%, will make it easier for the Fed to control the main target rate, which could be difficult amid the flood of cash sloshing around. A higher deposit rate gives banks incentive to park their excess funds at the Fed and less incentive to lend them out in the interbank market. In this way, the excess funds actually stay in the system, but their potential to create new money and higher inflation is neutralized.

The real question in all this is the timing, something policymakers are already hotly debating. The doves, who are in no hurry to tighten and are in the majority, point to the enormous slack in the economy, which is putting downward pressure on wages and prices and perpetuating the risk of deflation. The hawks say popular measures of underutilized workers and facilities can give misleading impressions of the amount of slack, as was the case in the 1970s. Plus, they worry that exceptionally easy policy could fuel expectations of higher inflation, which are hard to reverse once they become ingrained in business and consumer behavior.

The timing will boil down to when the Fed thinks the recovery is sustainable. Despite last quarter's solid 3.5% economic growth, clear improvement in the job markets, so crucial to sustainability, is still a ways off. Also, wage growth and inflation continue to slow. In the last two recoveries, the Fed did not begin to lift rates until unemployment had fallen notably.

The Fed's first verbal signal is not expected until the Dec. 15-16 meeting at the earliest, and it may not be until well into 2010 that the Fed will very carefully start to feel its way toward tightening. |BW|

THE FED'S DAUNTING TASK: REINING IN THE EXCESS



*Reserves beyond those banks are required to hold
Data: Federal Reserve, IHS Global Insight

BRAD TRENT; CHART BY LAUREL DAUNIS-ALLEN/BW

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NUMBERS

PENNY-PINCHING AMERICANS DOWNSIZE THE TRADE DEFICIT

by Tara Kalwarski/charts by David Foster

The U.S. trade deficit narrowed in August to $31 billion, or about half the size of a year earlier, as the downturn continued to depress demand for imported goods. Meanwhile, emerging markets, including those in Asia and South America, posted trade surpluses.

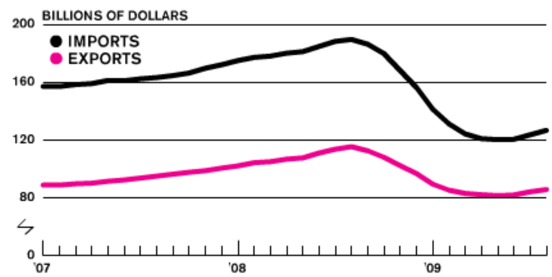
-12%

One-year change in import prices in September, vs. a 4% decline for non-oil imports. Export prices are down 6% over the period.

Data: Bureau of Labor Statistics

Imports' Steeper Slide: The value of imported goods has fallen further than that of exports.

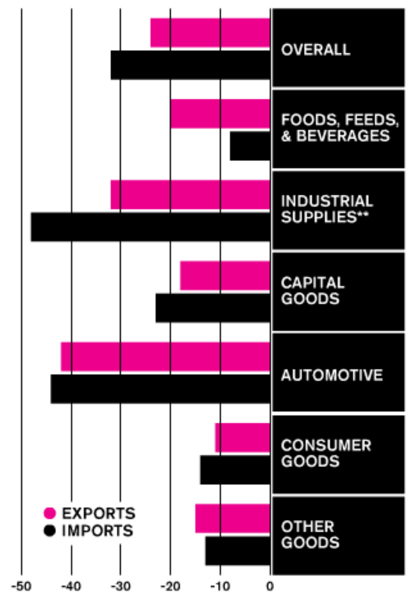
U.S. INTERNATIONAL TRADE IN GOODS*



*Seasonally adjusted; three-month moving averages
Data: Commerce Dept.

Across the Board: Trade in goods in the U.S. has dropped in every major category.

PERCENTAGE CHANGE IN YEAR-TO-DATE VALUE OF IMPORTS AND EXPORTS OF U.S. GOODS, VS. SAME PERIOD ONE YEAR EARLIER*

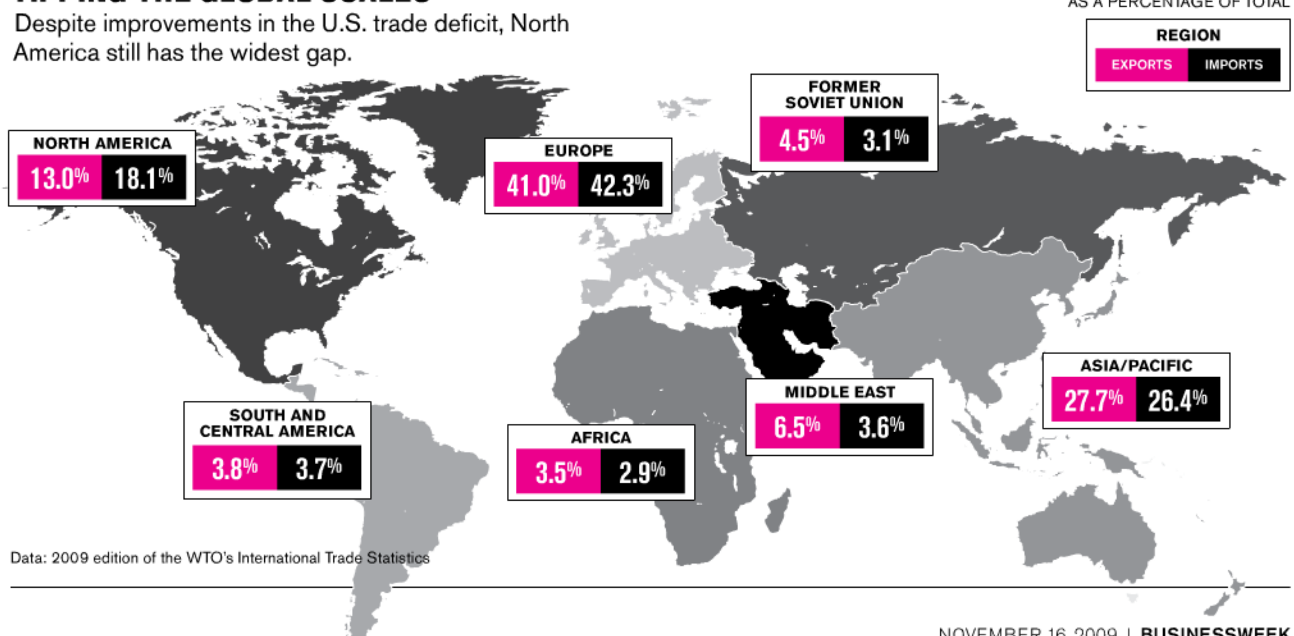


*Through August
**Includes petroleum and petroleum products
Data: Commerce Dept.

TIPPING THE GLOBAL SCALES

Despite improvements in the U.S. trade deficit, North America still has the widest gap.

SHARE OF WORLD MERCHANDISE TRADE IN 2008
AS A PERCENTAGE OF TOTAL



Data: 2009 edition of the WTO's International Trade Statistics

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THOMAS KUHLENBECK

ARE YOUR EMPLOYEES JUST BIDING THEIR TIME?

The high unemployment rate has scared working Americans into hanging on to their jobs at all costs. The Bureau of Labor Statistics says the "quit rate"—the portion of U.S. employees who voluntarily leave their jobs—was just 1.3% in August, about half the rate that prevailed when the BLS began collecting such figures at the end of 2000.

But don't count on workers' loyalty to outlast the recession. A survey by benefits consultant Watson Wyatt found that the "engagement," or loyalty, of top-performing employees has dropped by 25% over the past year, largely because people who kept their jobs have been soured by layoffs, bonus and benefit cuts, and a halt in promotions. "Employers are really nervous that the minute the job market picks up, all these people that are very disengaged are going to take off," says Laurie Bienstock, the firm's national practice director for strategic rewards.

The loyalty that employers enjoy now is "totally cyclical," agrees Sean Bisceglia, CEO of TalentDrive, which sifts through online résumés. Indeed, many employees are already hunting for other places to work. In a Monster.com survey back in May, 79% of jobholders said they had stepped up their search for a new place to work since the recession began.

Employers may not fully grasp what it takes to retain good people. In its latest biannual survey, released in October, temp firm Spherion Staffing Solutions asked about 300 employers and about 2,500 workers to name the top "drivers of retention." As they did in 2007 and 2005, the bosses listed soft stuff: "management climate" and "supervisor relationship," for instance. Employees' top two in all three surveys? Benefits and compensation. And this year, only 27% are "very satisfied" with their pay. Just 37% are equally happy with their benefits. *—Peter Coy*

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SANTA BETTER GET A MOVE ON

It's not even Thanksgiving, and some stores are already running out of hot toys. Blame cautious buying by retailers trying not to get stuck with unsold inventory, as they were last year. Among the items in short supply is a surprise hit: Zhu Zhu Pets, toy hamsters programmed to scamper around a plastic "home" whose rooms are connected by tunnels. The sets are sold out at Target.com and Wal-Mart.com. Some who scooped up Zhu Zhus early for $9.99 each are reselling them for twice that on Amazon.com and eBay. Meanwhile, the maker, tiny Cepia in St. Louis, is scurrying to get more shipments from China. Toys "R" Us says it ordered enough of the critters to keep shelves stocked (purchasers can buy only four at a time) but isn't offering them online or advertising them in flyers. Other hard-to-find items include Mattel's Mindflex game ($79), which includes a headset that picks up signals from the brain—the wearer tries to "think" a Ping-Pong ball through an obstacle course. On eBay it's going for twice its $79 suggested retail price. *–Christopher Palmeri*

Zhu Zhu Pets, one of this year's hot toys, are already hard to find

UP THE CREEK WHEN THAT RAINY DAY COMES

How well can Americans deal with a financial emergency? Almost half (46%) of 2,148 consumers surveyed recently said they weren't confident they could come up with $2,000 within a month in a crisis—from savings, family, friends, credit cards, or other sources. Even among those earning $100,000 to $149,000 a year, almost 25% doubted they could raise it, according to The Personal Risk Assessment and Risk Literacy Survey, conducted by research firm TNS with academics from Harvard Business School and Dartmouth College. "We wanted to know if people could fix a broken car or furnace," says Harvard finance professor Peter Tufano, who adds that most studies he has seen measure "how much [cash] people have ... not how much they can access." The survey results surprised him. "[The] ability to cope with emergencies is much less strong than we might have thought."

THE (HARD TO INSTALL) WINDOWS 7 WHOPPER

What delivers a marketing message—and a day's worth of calories? To publicize the release of Windows 7, Microsoft and Burger King's Japanese unit have teamed up to sell a seven-patty hamburger at the fast-food chain's outlets in Japan. And it's a hit: Originally scheduled for a seven-day promotion starting on Oct. 22, the Windows 7 Whopper—five inches tall and 2,120 calories—will now be offered until Nov. 6. The first 30 burgers sold each day at the company's 15 Japanese outlets go for 777 yen ($8.60). After that, the price jumps to $16. Sales tallied 15,600 through Nov. 3, with YouTube videos showing customers trying to get their mouths around the monster. The publicity is a welcome change for Burger King, which has strugged for visibility in Japan since reentering the country in June 2007. It withdrew in 2001, after losing a price war with McDonald's, which has more than 3,700 Japanese outlets. Burger King's return is part of the company's expansion into markets such as Egypt, Hong Kong, and Poland. *–Kenji Hall in Tokyo*

Burger King has a hit in Japan with this sky-high Microsoft promo



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A TAX HIKE BY ANY OTHER NAME

Why a lot of health reform's costs could be borne by the middle class, despite Obama's pledges

By Jane Sasseen

As a candidate and President, Barack Obama has had one core message for the middle class: I won't raise your taxes. The White House has pledged that only the wealthy—families earning more than $250,000—would face a boost in income, capital gains, or other taxes. For the 97% of Americans below that level, no increases are in store.

But as Congress inches closer to forging a massive package of health-care reforms, it's increasingly clear how difficult it will be to keep that pledge. To pay for the near trillion-dollar health-care system overhaul—not to mention reining in the deficit and funding other ambitious plans Obama has laid out for the years ahead—many outside the White House believe the middle class will not be spared. Republican critics contend that the White House is misleading the public about who will ultimately shoulder much of the cost of extending coverage to tens of millions of uninsured Americans.

True, most won't see direct tax hikes, per se. Few believe Obama will go back on his vow to keep income tax rates the same for all but the top brackets when the Bush tax cuts expire at the end of 2010. And top White House economic adviser Lawrence H. Summers says Obama can keep his pledge while finding more than enough costs cuts and revenue elsewhere. "There is substantial scope for expenditure reductions in health care and for raising enough revenues from people with incomes over $250,000 and from companies," he says.

A key question, though, is whether over the next couple of years, middle-income families will face a host of surcharges, fees, reduced tax breaks, or other increased costs. Daniel Clifton, a Washington-based policy analyst for Strategas Research Partners, argues that Congress has purposely loaded onto the corporate sector the increased taxes needed to pay for the reforms to avoid politically unpopular individual tax hikes. But the added costs will eventually be shifted to customers. "It all depends on what your definition of 'tax' is. Everyone is mincing words here," says Clifton. "There isn't enough money available in just extracting more from corporate taxes or rich Americans."

Congress has loaded the taxes needed to pay for reform onto corporations, but those costs may be shifted to customers

Consider the Senate's proposal to impose a 40% excise tax on so-called Cadillac health insurance plans valued at more than $21,000. The idea, say backers, is to discourage the excessive health-care spending said to result from such generous plans. The proposed tax on the plans would raise $202 billion, more than half the new funds needed to help pay for extending insurance coverage. Rather than tax policyholders directly, the hit would be on insurers who offer those plans.

WORRIED UNIONS

The insurers, though, likely will cut benefits or raise premiums as a result. That point hasn't escaped union leaders, who oppose the proposal because it would target many of their members, who have negotiated generous health benefits. Richard L. Trumka, the head of the AFL-CIO, argues that roughly 15% of insured families and 19% of individuals—most solidly middle-

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class—have plans that would fall under the new tax. For many members, he says, the result would be higher medical costs. "What [they are] actually saying is that cost of covering the uninsured should be borne by the middle class," Trumka says.

Summers counters that the tax is intended to curb wasteful health-care spending; the goal, he says, is to get employers to offer less pricey insurance policies and raise wages instead. But labor leaders remain unconvinced, and they're lobbying to kill the measure. GOP opponents of the reforms have also intensified their attacks. Senator Chuck Grassley (R-Iowa), the ranking Republican on the Senate Finance Committee, argues the pending bills would leave many worse off. "The vast majority of middle-class Americans would pay higher taxes and premiums," he says. He, too, cites the Cadillac tax increase, along with other changes such as a rise in the threshold on deductions for medical expenses from 7.5% of adjusted gross income to 10%. Quoting figures compiled by the bipartisan Joint Committee on Taxation, he says that by 2019, when the bill would be fully in effect, families earning over $75,000 would see a net hike in taxes.

On another front, the Senate is counting on hefty excise taxes assessed on the different players in the medical industry for a big chunk of funding. Altogether, insurers, drug companies, and device makers could be on tap for roughly $120 billion in fees over the next decade. Problem is, a big portion of those taxes are likely to be recouped in the form of higher prices or increased premiums. "It's a fiction," says Roberton Williams, a former Congressional Budget Office official now with the nonpartisan Urban Institute's Tax Policy Center. "The excise taxes won't be paid by the companies; they'll be passed right back to their customers."

Summers disputes that notion and argues that the excise taxes "are designed so they will likely be difficult to pass on." And he points out that the estimates Grassley cites do not take into account expected cost savings and other benefits of reform. "Many of those same firms will no longer have the burdens associated with paying for uncompensated care," he argues.

However the numbers are sliced, they add up. All told, by imposing new taxes on health-care providers, the Senate Finance Committee is counting on raising some $340 billion to help pay for reforms. An additional $42 billion would come from trimming tax breaks for such things as health savings accounts and medical expenses, according to fiscal watchdog US Budget Watch. It remains to be seen how much of that tab average Americans will end up shouldering. |BW|

RAFAEL RICOY

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032

WHY BIG OIL IS GOING BACK TO IRAQ

In June energy giants balked at Baghdad's terms. On the heels of a BP deal, they now fear being left out

By Stanley Reed

Not long ago, Iraq's oil industry seemed stuck in the desert sand. Today, it's reshaping the global energy game and threatens to throw the dynamics of OPEC off kilter.

This past summer, ExxonMobil, Royal Dutch Shell, Eni, and others walked away from bidding on rich Iraqi fields, balking at the tough terms Baghdad was proposing. Now they're back—getting roughly the same deal that was on the table in June. On Nov. 2, Eni initialed a contract to boost production in the Zubair field near Basra, which Eni estimates has 6 billion barrels of reserves. Shell, Exxon, and ConocoPhillips are also in talks that could help boost Iraq's production to more than 6 million barrels per day—behind only Saudi Arabia in OPEC.

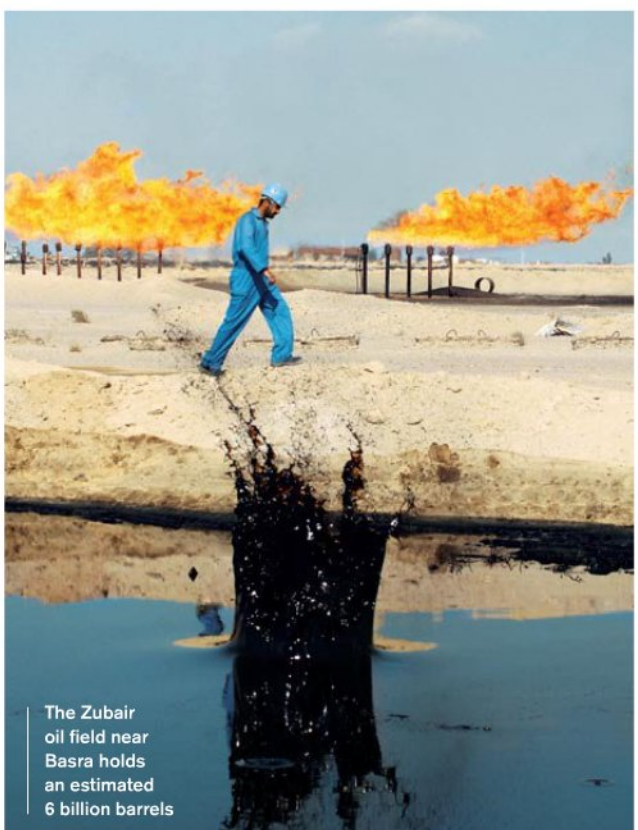
The big oil companies are reconsidering Iraq because they fear this may be their last opportunity to get big volumes of crude. And after BP and China National Petroleum Corp. agreed to Iraq's terms in the wake of the June auctions, the others realized they were unlikely to get a better deal. Under the BP/CNPC contract, signed Nov. 3 at a ceremony in Baghdad, the companies are to nearly triple output at Rumaila, about 30 miles west of Basra. BP's group will recover all costs and receive $2 in profit for each barrel beyond a 10% increase above today's production. "It is fair to say that there are many people negotiating now who would not have taken $2 before," Shell Chief Financial Officer Simon Henry told reporters on Oct. 29.

The change of heart could increase tensions in OPEC, which had assumed Iraq's production would remain low for several more years. As Iraqi output starts to rise, the Saudis and other big producers could try to persuade Iraq—which belongs to OPEC but is exempt from its quotas—to toe the line. The Iraqis, though, may want to pump the maximum, arguing that other cartel members who have profited from Iraq's troubles for years should bear any production cuts.

In any event, Iraq's opening is likely to change the global energy picture. Its reserves stand at some 115 billion barrels, the third-largest in the world. Three fields alone—Rumaila, Zubair, and West Qurna—could nearly triple Iraqi production in less than a decade. And much of Iraq remains relatively unexplored, so many in the industry see the possibility of finding huge new fields. "If Iraq and the international oil companies are able to bring these projects on," says David Kirsch, an analyst at Washington (D.C.) consultant PFC Energy, "it certainly would eliminate concerns that global production is going to peak anytime soon."

Of course, big obstacles remain. Security will clearly be a worry. If Prime Minister Nouri al-Maliki, who has promoted the oil deals, is ousted in January elections, the investment climate could sour. And projects that do go through could be hampered by a shortage of skilled workers and infrastructure woes such as a lack of oil terminals and pipeline capacity to export Iraqi crude.

For Eni and the others now back at the table, the potential rewards are worth those headaches. Eni's deal is similar to BP's. Eni and its partners, Occidental Petroleum and Korea Gas, are to increase output at Zubair from the current level of 190,000 barrels per day to 1.125 million within seven years. They'll get the same $2 per incremental barrel that BP received, though they had initially wanted $4.80. Claudio Descalzi, Eni's exploration and production chief, says Baghdad also clarified how much tax the foreigners would have to pay, which made the deal more attractive. In the end, Descalzi says, "we got a contract that guarantees us the right returns." BW



The Zubair oil field near Basra holds an estimated 6 billion barrels

ESSAM -AL-SUDANI/AFP/GETTY IMAGES

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Assembling the 787 Dreamliner in Everett, Wash.

ROBERT SORBO/REUTERS

BOEING'S FLIGHT FROM UNION LABOR

Wages will be lower at its plant in South Carolina. But the company may risk further delays of the Dreamliner

By Dean Foust and Justin Bachman

To outsiders, Boeing's recent announcement that it will build a second assembly line for the 787 Dreamliner in North Charleston, S.C., is the latest twist in the much delayed project. To Boeing's heavily unionized workforce in Seattle, though, the decision is tantamount to war—and could provoke a backlash that makes production more fractious.

By locating some production and an estimated 3,800 jobs across the country, CEO W. James McNerney Jr. is signaling the lengths he's willing to go to loosen the union's chokehold on the company. The last thing he wants, insiders say, is for Boeing to become yet another U.S. manufacturer hamstrung by costly labor and recalcitrant unions when competition from China and India looms. His efforts to extract concessions last year triggered a 57-day walkout by machinists that cost the company $2 billion and prompted some airlines to shift orders to Airbus. In Boeing's Oct. 21 earnings call, McNerney noted the benefits of "diversifying our labor pool and labor relationship."

For Boeing, the payoff from the line in South Carolina is significant. Workers at an existing plant Boeing operates there average $15 an hour, vs. the $26 or so earned by unionized workers at Boeing's assembly lines in Everett and Renton, Wash. Says a Boeing vice-president, Doug Kight: "We are at the top of the market in wages, pension, and health care."

PAY DISPARITY

Average hourly wage for aircraft assembly workers

South Carolina	$15
Washington State	$26

Data: Boeing

But the move to the South injects even more risk into a project that's already two years behind schedule. The $750 million plant represents the first final assembly line Boeing has built from scratch since the late 1960s and the first ever outside the state of Washington. Operations in Charleston haven't always run smoothly: Boeing was forced to assume control of a subcontractor's operations in July because of delays and quality issues.

While adding the South Carolina line could help Boeing catch up on its backlog of roughly 840 orders for the Dreamliner, in the short run the plant may eat into the company's cash flow, which stands at $6.6 billion. Some analysts believe it could take Boeing up to four years from the expected July 2011 opening to bring the new line up to full speed. And while the company still expects the 787 to be a moneymaker, analysts think trying to start up a plant could push out the break-even point for the 787, which Boeing has hailed as a game-changer for its fuel-saving design.

At the same time, Boeing's decision to make the move has angered members of the International Association of Machinists. Scott Hamilton, an industry consultant in Issaquah, Wash., says the unions could protest the move by engaging in "work by the rules" actions that slow production or by tagging work that comes from South Carolina to Everett as being not up to specifications.

What's more, the Washington workers say they're already fixing 787 mistakes that were made elsewhere by the larger-than-normal pool of subcontractors Boeing uses—and they expect more as it disperses assembly. "If they continually offload and go into areas of nonskilled workers, they're just not going to have that quality product," says Tom Wroblewski, president of IAM District 751 in Seattle, which represents Boeing machinists.

Boeing remains confident of its ability to launch the line successfully. Even so, the company's efforts to break its dependence on unions comes at a critical time. |BW|

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IS IT CalPERS' TURN TO CLEAN HOUSE?

The powerful California pension fund is catching flak for not practicing what it preaches



By Christopher Palmeri

The California Public Employees' Retirement System has long pushed companies to clean up their acts. Now the nation's largest pension fund is getting flak for its own governance practices. But while other pension funds are overhauling their policies on hot-button issues—including campaign contributions and investment middlemen—CalPERS is making only marginal changes.

The worry among shareholder activists is that this new perception may hamper CalPERS' ability to enact change elsewhere. "It's embarrassing for CalPERS," says Charles M. Elson, chair of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "What's the old saying about people who live in glass houses?"

HUGE SUMS AT STAKE

The main concerns center on the pension fund industry's relationship with money managers. CalPERS and the like dole out huge sums of money to financial firms to invest. Some worry that money managers are making campaign donations to elected officials to win lucrative state investment contracts with CalPERS and other pension funds. Others take aim at so-called placement agents, middlemen who get paid for steering those contracts to outside investment firms. As the largest—and one of the most powerful—pension funds, CalPERS is a prime target for critics. CalPERS defends its policies. Chief Investment Officer Joseph Dear says the pension fund takes great care to avoid potential conflicts of interest.

Over the years, the $200 billion pension fund has used its hefty financial clout to push for change at the companies in which it owns shares. It has railed against excessive pay for CEOs, campaigned to eliminate conflicts of interest on Wall Street, and lobbied to give investors a bigger voice at annual meetings. "It's always fun to hear them take companies to the woodshed," says John M.W. Moorlach, a county supervisor in Orange County, Calif. CalPERS called for the ouster of Walt Disney Chairman Michael Eisner in 2005 over weak stock returns, as well as New York Stock Exchange Chairman Richard Grasso, whose pay the fund called excessive in 2003.

Now CalPERS, which provides retirement and health-care benefits to 1.6 million state workers, is feeling the heat. Prosecutors, regulators, and lawmakers are taking aim at state pension funds for a broad range of ethical issues. For example, New York Attorney General Andrew M. Cuomo earlier this year announced an investigation into pension fund abuses. Other big pension funds are changing their ways in response to the pressure. But CalPERS seems to be resisting.

CalPERS has fought to get companies to hold annual full-board elections—but it follows no such practice itself

Consider the issue of campaign contributions. Some money managers with state contracts donate to the campaigns of elected officials, who typically populate the boards of pension funds like CalPERS. The concern is that these contributions could influence how officials award pension fund investment contracts.

The Securities & Exchange Commission is considering a ban on such donations to elected officials. While CalPERS says it supports the SEC's proposal, it has asked in comments to the agency that the ban not apply to political action committees (PACs),

CHRISTOPH NIEMANN

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CONCERNS ABOUT CalPERS

A fierce advocate for corporate reform, the nation's largest pension fund takes a softer approach to in-house change.

CAMPAIGN CONTRIBUTIONS

CalPERS supports an SEC ban on donations that money managers with state investment contracts make to elected officials. Other states go further.

PLACEMENT AGENTS

While other funds have stopped working with the middlemen, CalPERS is "neutral" on the matter.

BOARD OF DIRECTORS

The pension giant pushes companies to elect their boards each year, though most CalPERS board members serve four-year terms.

political parties, or charities associated with officials, unless the officials are soliciting the contributions. Other states have already implemented these sorts of restrictions. In New Jersey, the donation ban applies to 120 state officials and their PACs. CalPERS says the current disclosure requirements for board members are sufficient.

That may be, but such contributions are raising eyebrows. Former board member Sean Harrigan, for example, solicited large donations from money managers for a union fund while at CalPERS. The longtime union official has been subpoenaed by the SEC and the California attorney general as part of a broader probe into pension fund abuses. "He has absolutely done nothing unethical or illegal," says Harrigan's attorney, Mark Byrne.

Critics say CalPERS' response to the debate over placement agents is even more disappointing. Placement agents, the middlemen who direct state investment contracts to money managers, have been the subject of state and federal probes in recent months. The SEC is considering an outright ban on these players—and several pension funds have preemptively decided to restrict their money managers from using placement agents.

CalPERS hasn't. The California pension fund's official position on the SEC proposal is "neutral." "If the only way you are able to get access is to pay someone to use their connections, then you shouldn't get that business," says Mercer Bullard, a law professor at the University of Mississippi and advocate of pension fund reform. "It's morally wrong."

CalPERS' Dear says placement agents play a useful role in connecting big funds with small money managers, who don't have ample marketing staffs. CalPERS recently hired the law firm Steptoe & Johnson to review its relationship with these middlemen. It also asked investment bank Houlihan Lokey to assess the pension fund's lineup of outside money managers to see if they're doing anything improper or charging too much for their services. "One of the major expenses of running a fund is fees," says Dear. "I'm determined to get a deal for our fund."

These sorts of issues have been dogging CalPERS of late. In October the California pension fund disclosed that Arvco Financial Ventures, a placement agency run by former CalPERS board member Albert Villalobos, had received $50 million in fees for winning state investment contracts on behalf of money manager Apollo Global Management over a five-year period. Even Dear said the sum "amazed" him. Villalobos didn't return calls.

WEDDING FAVORS

Adding to the controversy, Villalobos hosted a wedding in 2004 at his Nevada mansion for CalPERS then-Chief Executive Fred Buenrostro, according to a Nov. 3 article in *The Sacramento Bee*. Buenrostro said he didn't have to disclose the wedding under state rules. "It's not whether it is right or wrong, it is the appearance of impropriety," says William J. Pollacek, treasurer for California's Contra Costa County.

Meanwhile, CalPERS' practices seem to be at odds even with its own advice for companies. In recent years the pension has fought hard to get companies to hold annual elections for the entire board so that directors will be held more accountable. That means getting rid of so-called staggered terms in which only a handful of board members come up for a vote each year. At CalPERS' urging, hospital bed maker Hill-Rom Holdings announced on Oct. 6 that it would eliminate staggered terms for its board.

CalPERS itself has no such policies. None of its board members sit for an annual election; most serve four-year, staggered terms. CalPERS says its board election process is far more democratic than that of the typical company, where even getting on the ballot can be difficult. Nonetheless, says a CEO at a large company that has been targeted by CalPERS over this issue: "I don't think they have the moral high ground. They have a lot of issues in their shop." | BW |

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Under Mulally, the company is bringing out stylish, fuel-sipping models

THE ENGINE FINALLY TURNS OVER AT FORD

It has posted its first profit in three years, and the company's brands are showing surprising strength

By David Welch

For years it has been fashionable to dump on Detroit's cars as lacking in style, quality, and fuel-efficiency. But if Ford Motor's third-quarter results—the first profit since 2005—are any indication, there may be life in American car brands after all.

Of course, CEO Alan Mulally made clear that one good quarter does not a turnaround make. The economy remains anemic, and millions of people are more concerned with finding or keeping their jobs than buying a new vehicle. It is also true that Ford's $1 billion in profit rests in part on Mulally's skillful use of his cost-cutting scalpel.

All the same, there is growing evidence that Ford's vehicles are starting to resonate with buyers in ways that didn't seem possible even a year ago. If Ford can maintain the momentum, it could get off the Detroit treadmill—restructuring from one crisis to the next—and eventually achieve sustained profitability. "Alan," says Edmunds.com CEO Jeremy Anwyl, "is getting the company on the right track."

Staying out of bankruptcy court and off the government dole has helped Ford steal customers from Chrysler and General Motors. And like most automakers, Ford benefited from the U.S. government's cash-for-clunkers program. But consumers have shown a willingness to pay up for Ford vehicles. In the most recent quarter, Ford attributed $1.9 billion of revenue to fatter prices. Yes, cash-for-clunkers helped. But Ford also fetched more per vehicle in the spring, long before the government program went into effect.

In another sign of strength, Ford has pulled back on discounts, even as GM continues to offer hefty deals. Last month, Ford spent an average $2,909 per car in incentives, according to Edmunds.com, about 25% less than it did a year ago and almost $1,400 per vehicle less than GM.

$1.9 billion

Amount of Ford's $28 billion in third-quarter revenue that can be attributed to the pricing strength of its new models

Data: Ford Motor

What's behind the increasing luster of Ford's brands? In the past two years the automaker has released a bevy of new models, including a refreshed Fusion, Taurus, new F-150 pickup, and Lincoln MKS sedan. Many of these vehicles are winning kudos for style and fuel economy and rank right up there in the quality stakes with Toyota Motor and Honda Motor. The Taurus, brought back from the dead at Mulally's insistence and once considered a risky bet, starts at $26,000. That is pricer than the sedan it replaced. Even better, 20% of buyers opt for the high-performance Taurus, which starts at a BMW-like price of $37,000.

Ford still has a ways to go. While more consumers are looking at its cars, Edmunds.com reports that the percentage of buyers kicking the tires of Ford's models on its car-shopping site fell in September after the government's clunker program ended. What's more, Ford is still having trouble getting traction on the U.S. coasts, where the Japanese and Europeans have long held sway. Plus, many shoppers are more likely to compare Ford models with vehicles from GM than from Toyota or Honda, another sign it needs to do a better job wooing import lovers.

But with Ford gaining market share and pricing power in a lousy economy, Mulally & Co. have much to show for their efforts. "Sometimes in the past our brand was viewed as downscale," says Mark Fields, who runs Ford's Americas operations. "But it is improving. It's not smoke and mirrors." | BW |

ANDREW HARRER/BLOOMBERG NEWS

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040

HIP BERLIN GOES CORPORATE

With its long recession finally ending, Germany's biggest city has become a magnet for businesses



Nokia's Halbherr says people from all over Europe are willing to transfer to the city

SEAN GALLUP/GETTY IMAGES

By Jack Ewing



When the Berlin Wall opened two decades ago, freedom quickly swept through Germany's largest city. Prosperity, by contrast, was much slower to arrive. After the euphoria of reunification wore off, Berliners endured a recession that lasted almost without pause from 1996 to 2004. Even as imposing new government buildings rose along the stately Unter den Linden, the city of 3.4 million was in an economic funk.

Now, as Berlin celebrates the 20th anniversary of Nov. 9, 1989—the day East German apparatchiks threw open border crossings—its status as Germany's hippest and most affordable big city is finally translating into growth. Berlin has become a magnet for Internet and media startups as well as established corporations eager to tap the city's well-educated young people. Drugmaker Pfizer moved its German headquarters to the capital from Karlsruhe last year. The top creative people of ad agency BBDO Germany will soon be in Berlin instead of Düsseldorf. And Finnish handset maker Nokia has based its mobile mapping operations in Berlin since it bought local software startup gate5 in 2006. "You can recruit people from all over Europe to come to Berlin," says Michael Halbherr, the former chief of gate5 and now a Nokia vice-president.

> **Berlin's growth last year exceeded the national average, and this year its downturn has been the mildest of any German region**

One advantage is that after a violent and traumatic 20th century, Berlin has been able to reinvent itself in the 21st. The city is famous for its evolving arts and fashion communities and a lively club scene. In the former East Berlin's Mitte neighborhood, young people from across Europe chug tall glasses of beer at Clärchens Ballhaus, a retro-hip dance hall; in the summer Berliners pack outdoor hangouts on the Spree River. "There is a lot of creative freedom," says Christophe Maire, a native of Switzerland who is CEO of Txtr, a Berlin startup that's planning to sell an e-reader to compete with Amazon.com's Kindle.

CRUCIAL SEED GRANT

It's tough to quantify the economic benefits of hipness, but there's no question Berlin has been doing a lot better recently. Growth of 1.6% in 2008 was above the national average, and this year the city has suffered the mildest downturn of any German region, with output falling 2.3% through June vs. 6.8% for the country as a whole. Although the unemployment rate of 13.6% is Germany's highest, Berlin ranks near the top nationally in job creation. Most important, Berlin has largely dealt with the economic legacy of the Cold War. Merging East and West Berlin created a bloated bureaucracy that took years to pare, but by last year the city had balanced its budget—although the global economic crisis has thrown public finances into disarray again.

Markus Hannebauer bet on Berlin back in 2001 and is now enjoying the payoff. When he was founding think-cell, which develops software that helps craft PowerPoint presentations, he considered going to the U.S. But a small seed grant from the city persuaded him to stay, and today his company enjoys sales of more than $10 million. "Berlin," he says, "has no competition." | BW |

—With Moira Herbst in Berlin

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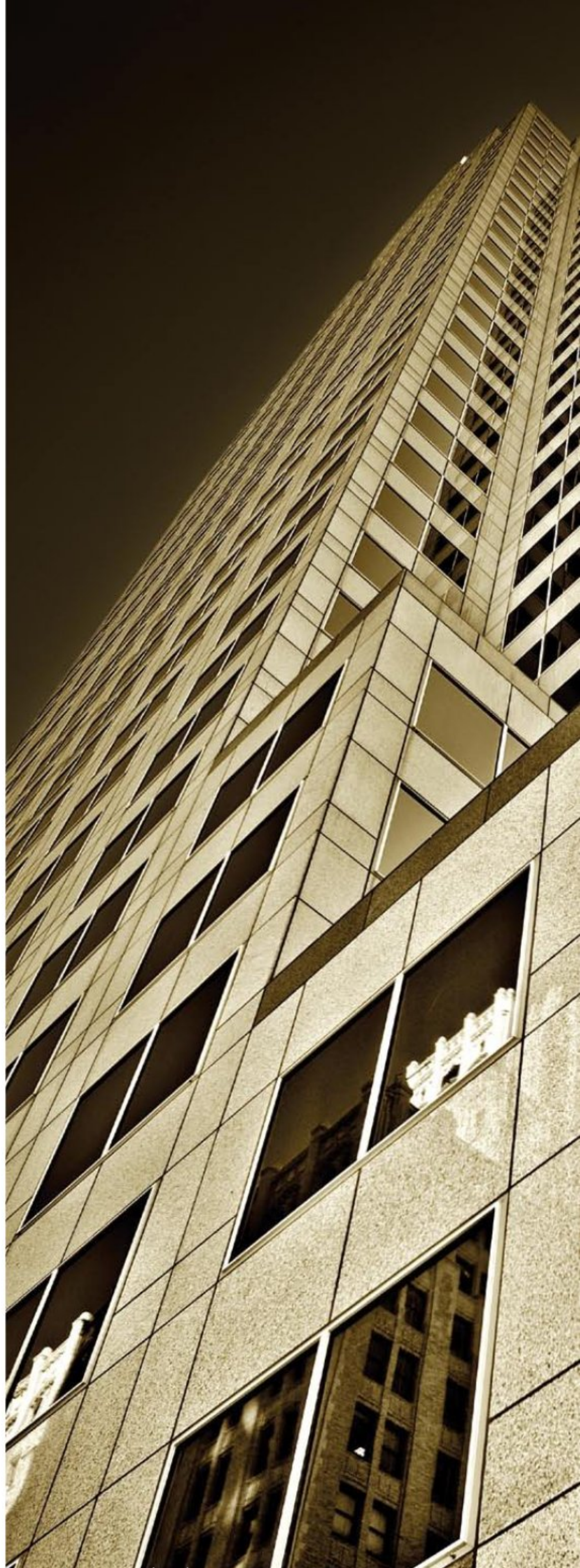
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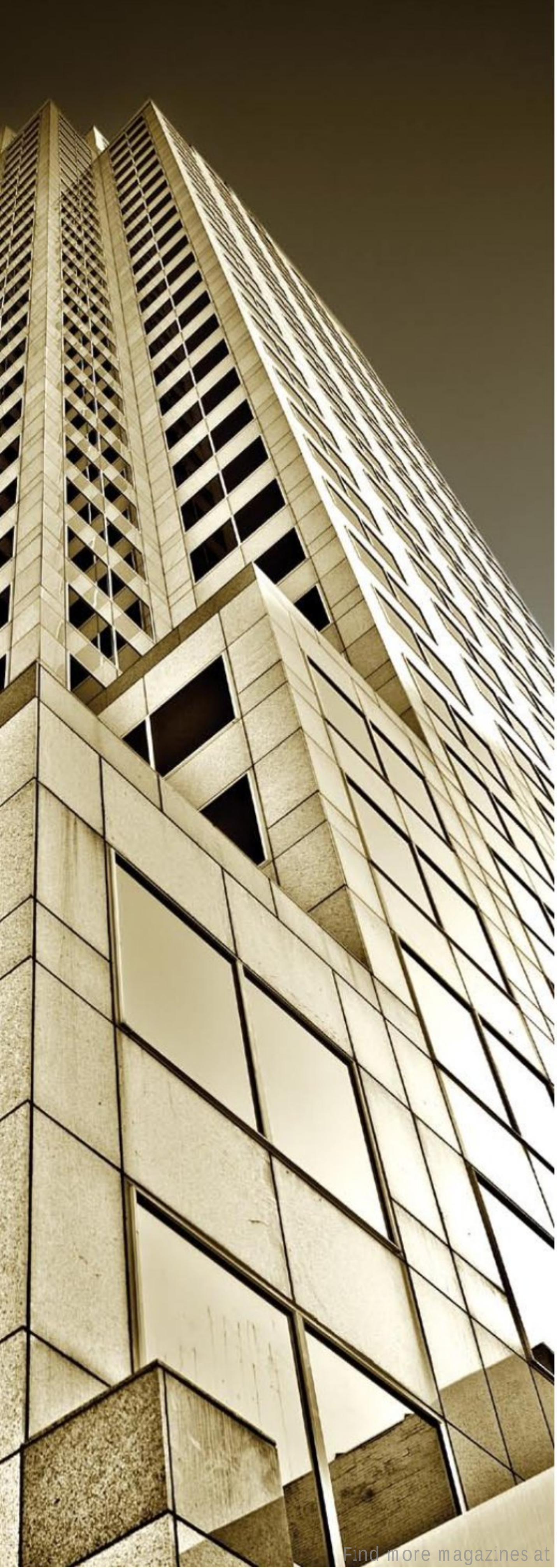
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WHY THIS BUST IS DIFFERENT



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By Mara Der Hovanesian and Dean Foust

Photograph by Richard Morgenstein

When Goldman Sachs sold complex bonds backed by the Arizona Grand Resort and other commercial properties in 2006, it suggested the returns would be strong. The 164-acre luxury Arizona Grand, set against the Sonoran Desert in Phoenix, boasted an award-winning golf course, deluxe spa, and several swank restaurants. The on-site water park was named one of the best in the country by the Travel Channel. With the resort's new owners planning to refurbish hotel rooms and common areas, Goldman told investors that the renovations would help boost cash flow. ¶ As was so often the case during the real estate boom, the lofty projections didn't pan out. When the economy softened and business travel slumped, Arizona Grand's bookings slipped to 67%, from 80%. The resort defaulted on the $190 million underlying loan in 2009—a hit that alone could largely wipe out investors who bought the riskier pieces of the Goldman mortgage-backed securities deal.

Unrealistic assumptions, layers of investors, sky-high prices, and possible fraud will make it hard to clean up the mess in commercial real estate

"It's one of the largest losses we have forecasted for an individual loan," says Steve Kuritz, a senior vice-president at Realpoint, an independent credit-rating agency. The property, once valued at $246 million, is now worth just $93 million. A spokesman for Goldman says the pricing on the bonds was in line with market levels at the time and not above what investors could get on similar securities. Grossman Co. Properties, which owns Arizona Grand, didn't return calls for comment.

It would be easy to write off this blowup as just another casualty in the regular boom-and-bust cycle of the $6.4 trillion commercial real estate market. But the Goldman deal, with its unrealistic assumptions, multiple layers of investors, and stratospheric prices, helps illustrate why this downturn is more complicated than previous ones—and will turn out to be far costlier. Already, prices have plunged 41% from the peak in 2007, according to Moody's/REAL Com-

In 2007, 333 Bush St., San Francisco, sold for $518 per square foot

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ERIK PETERSEN/BOZEMAN DAILY CHRONICLE

Blixseth, some months before his Yellowstone Club in Montana filed for bankruptcy

mercial Property Price Index—worse than the 30.5% fall in the housing market from its 2006 apex. "We've never seen this extreme a correction as far back as the data go, which is the late 1960s," says Neal Elkin, president of Real Estate Analytics, the research firm that created the index. Adds billionaire investor Wilbur Ross: "Commercial real estate has gone from being highly liquid at sky-high prices to being extremely illiquid at distressed prices."

To appreciate why this bust is like no other, first consider the typical commercial real estate downturns that used to crop up every 5 or 10 years. The pattern was predictable: When prices for apartment complexes, office buildings, shopping malls, and other properties began to rise, developers sped up their projects to cash in on the bull market. Eventually, some of those developers, unable to fill all the new space, began to default on their loans, and lenders were stuck with the buildings they'd financed. The slump lasted no longer than the time it took for the property glut to be worked down.

TURNING A BLIND EYE

But overbuilding isn't the culprit in this bust. An oversupply of money is what pushed commercial real estate over the edge.

It turns out the same excesses that drove the housing market's crazy rise and fall were present in commercial real estate, too—but they have largely gone unnoticed until now. Bankers, in their haste to make more and bigger loans, blindly accepted borrowers' wildest growth assumptions and readily overlooked other shortcomings on loan applications. They did so in part because they could easily sell their dubious loans to investors in the form of commercial mortgage-backed securities. As the market overheated, it became a breeding ground for fraud: A flurry of new court cases reveals the disturbing extent to which commercial mortgage borrowers may have doctored loan documents.

While the housing crisis seems to be easing, the commercial storm is still gathering strength. Between now and 2012, more than $1.4 trillion worth of commercial real estate loans will come due, according to real estate investment firm ING Clarion Partners. Analysts at Deutsche Bank estimate that borrowers will have trouble rolling over as many as three-quarters of the loans they took out in 2007, the most toxic vintage.

$6.4 billion

The amount of commercial real estate investments that didn't qualify for refinancing during the first 10 months of 2009

Data: Barclays Capital

For the banks and investors whose money fuels the economy, this presents major problems. Their losses will likely cast a shadow over lending—and, by extension, the overall economy—for years. The market won't fully recover until 2020, says Kenneth P. Riggs Jr., CEO of Real Estate Research, and in cases where "values were over the top ... maybe never."

In the short term, toxic securities are creating a new problem weighing on the market: a tangle of interconnected investors fighting over the remains of the properties they own. In the past the damage was limited to a handful of lenders who invested directly in any given project. Now there can be dozens of groups

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of investors, each with its own agenda. The April bankruptcy of shopping mall owner General Growth, one of the largest real-estate-related bankruptcies ever, affected hundreds of parties—an unprecedented slicing and dicing of assets. These investors won't soon forget the bust and aren't likely to dive back into the market as aggressively as they once did.

And yet the securities are only a secondary problem. The main driver of the commercial real estate bust is the underlying loans. How frothy did the market get? In one notable example, New York investment fund Sterling American Property and real estate company Hines paid $281 million in 2007 for the 42-floor office building at 333 Bush St. in San Francisco. That worked out to $518 a square foot, far higher than today's price, according to Real Capital Analytics, a research firm. Less than two years later, the building's primary tenant, law firm Heller Ehrman, filed for bankruptcy and stopped making rent payments. According to Real Capital Analytics, the building's owners did not make a recent loan payment, and the lender is expected to begin foreclosure proceedings. Says a spokesman for Sterling and Hines: "[We] continue to own and operate the property."

$1.7 trillion

The total value of commercial loans on banks' books—roughly 25% of assets for the average institution

Data: Deutsche Bank

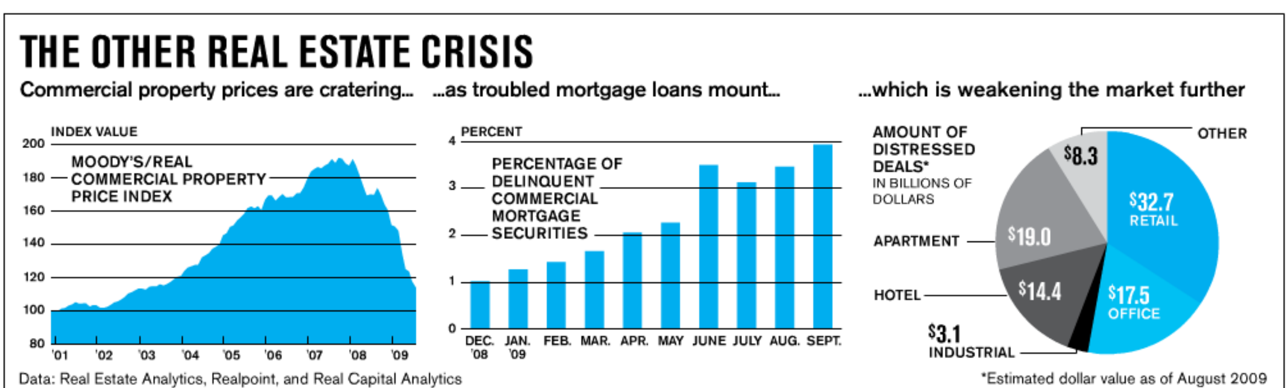
What's striking is how quickly some big commercial deals have gone south. In April 2007, Charney FPG, a New York real estate partnership, paid about $180 million to buy a 22-story office building in Manhattan's Times Square district. It borrowed $202 million to pay for the purchase, renovations, and incidentals—111% financing. Because the rental income didn't cover the debt payments, Comfort's lenders, Wachovia and RBS Greenwich Capital, required the firm to set aside $10 million in reserves to keep the project afloat until it got more paying tenants. Those occupants never materialized, and by July the owners had exhausted 95% of their reserves. The building is now in jeopardy of being seized by the bankers, says Real Capital Analytics' head of research, Dan Fasulo. "Everyone knows Judgment Day is coming." Says a Charney spokesman: "The owners are in the midst of restructuring the debt." Wachovia and RBS declined to comment.

Commercial lending mirrored mortgage lending in another way: Loans were made based on an unshakable belief that the market would never go down. An analysis by research firm REIS of mortgage securities created between 2005 and 2008 found that income projections for properties exceeded their historical performances by an average of 15%. "It was all based on assumption of cash flow," says Howard S. Landsberg of New York-based consultant Weiser Realty Advisors. "If you couldn't afford to pay the bank back now, in three years you could count on another $20 a square foot" in rent. When the numbers didn't add up, some lenders got imaginative. Says a banker at a large Wall Street firm: "If the cash flow wasn't there, you had to ignore it or find ways to create it."

Some lenders may have drummed up business for themselves, enticing borrowers with more money than they needed. Consider Credit Suisse's $375 million loan to the Yellowstone Club in Big Sky, Mont., one of the starkest examples of poor underwriting in recent memory. Opened in 1999 by Timothy L. Blixseth, a welfare kid turned timber magnate, the private ski and golf club catered to the ultra-wealthy crowd. Microsoft founder Bill Gates and Tour de France champion Greg LeMond built multimillion-dollar vacation homes there. In 2005 a Credit Suisse banker approached Blixseth about a loan, which the banker compared to "a home equity loan," according to bankruptcy court documents. Blixseth initially turned down the offer. But after several calls and a personal visit to Blixseth's home near Palm Springs, Calif., the banker persuaded Blixseth to borrow $375 million in the name of the club. According to court papers, the two decided the transaction fee by coin flip; Blixseth won, agreeing to pay 2%.

"WILD, OUT-OF-CONTROL SPENDING"

But not all of the funds were earmarked for the club. The deal allowed Blixseth to use up to $209 million of the proceeds "for his own personal benefit," according to the bankruptcy court papers. In a civil lawsuit filed by Yellowstone investors and homeowners, the plaintiffs say Blixseth used some of that money to fund a lavish lifestyle, including the purchases of a 20-seat Gulfstream corporate jet, two Rolls-Royce Phantoms, and three Land Rovers. His ex-wife, Edra Denise Blixseth, may have benefited from Credit Suisse's largesse, too. In a legal declaration filed in a Montana court, Timothy Blix-



Data: Real Estate Analytics, Realpoint, and Real Capital Analytics

*Estimated dollar value as of August 2009

CHART BY DAVID FOSTER

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seth notes her "wild, out-of-control spending." Among her extravagances, he alleges, was a "divorce celebration party" with "a voodoo doll game whereby the guests could poke pins in a life-size doll in my image to inflict pain on my various body parts." Timothy Blixseth's attorney says his client used the "vast majority" of the funds for business purposes. Blixseth, the attorney says, plowed money into an international expansion plan, including the purchase of "golf and resort properties in Mexico, the Caribbean, and elsewhere," as well as the Gulfstream jet. Edra Blixseth could not be reached for comment.

While Blixseth was busy spending the money, Yellowstone was struggling under the weight of its debt. Vendors often went unpaid for three months or longer, according to bankruptcy court testimony. In November 2008, Yellowstone filed for bankruptcy protection. "The only plausible explanation for Credit Suisse's action is that it was simply driven by the fees it was extracting from the loans it was selling and letting the chips fall where they may," said Ralph B. Kirscher, a federal bankruptcy judge in Helena, in a May court decision. Timothy Blixseth's attorney says the bankruptcy was prompted by his client's divorce proceedings. A spokesman for Credit Suisse says: "We worked on behalf of the institutions that held this loan." (The judge vacated his decision after the bank agreed to settle with Yellowstone's new owners, which include money manager Cross Harbor Capital Partners.)

RED FLAGS GALORE

The banks were hardly the only freewheeling players during the credit boom. The fast-and-easy lending environment was fertile territory for alleged fraudsters. In 2007 Prudential Financial lent $13.9 million to Namir A. Faidi, a Houston developer who planned to use the money to pay off construction loans on Piazza Blanca, a Mediterranean-themed shopping complex in Galveston, Tex. Faidi dipped into the project's reserve fund to make the first loan payment but failed to make any more. After that, Prudential concluded that some of the leases he'd submitted weren't legitimate. According to a civil suit filed in federal court by Prudential, Faidi's loan papers included a signed lease from time-share giant Bluegreen, a purported tenant that would occupy 26% of the space. But when Prudential contacted Bluegreen after the default, it learned it had backed out of talks and never signed a rental agreement.

In court proceedings, a Bluegreen employee said the signatures on the documents weren't his. Another supposed tenant, Mia Group, said in court filings that the lease on file for the restaurant company was invalid because it was signed by a business associate who didn't have authority to do so. "He was a few leases short of what he needed to get the loan," says Andrew F. Spalding, a Houston attorney who is representing Prudential. "I'm sure his thinking was just like that of most other developers: Even if the tenants were fake, he figured he could still fill that space in no time with someone else."

An attorney for Faidi, Robert A. Axelrad, says the disputed lease for Bluegreen was arranged by an outside broker. He acknowledges that the loan application included future rent payments from Bluegreen, but he says the figures were meant to be "pro forma" estimates based on the possibility of Bluegreen occupying the space. "My client says he never saw the lease and never represented there was a lease," says Axelrad. Faidi filed for personal bankruptcy in September. The civil case is ongoing.

Glaring problems that normally would have raised red flags seemed to be in plain sight of loan officers during the credit boom. Phoenix entrepreneur John J. Wanek appeared to have the right credentials when he applied for a $6.5 million loan from Merrill Lynch to buy the Ashberry Village Apartments in 2002. The sprawling ranch-style complex in Columbus, Ohio, would be the latest addition to his small, Midwestern real estate empire. He had never missed a payment on a half-dozen similar properties. And the rent rolls Wanek provided showed that more than 90% of Ashberry's units were occupied. After Wanek defaulted within six months, Merrill concluded that it had been duped. It claimed in a civil suit filed in a Franklin County (Ohio) court that Wanek had altered the rent-roll numbers to make the complex look more profitable. Merrill, which is now owned by Bank of America, contends that the complex was nearly one-third vacant at the time, and that Wanek had "grossly understated" the operating expenses. According to the suit, Wanek had inflated the numbers to get a bigger-than-necessary loan and used the extra money to cover back payments on other apartment buildings.

30

The number of big U.S. cities, including Las Vegas and New York, saddled with at least $1 billion in troubled commercial loans, up from eight a year ago

Data: Real Capital Analytics

Even if the allegations are true, Merrill should have seen the warning signs. According to the suit, after applying for the loan, Wanek told Merrill he would transcribe data from the previous owner's supposedly illegible rent rolls into easier-to-read spreadsheets. In the process, he boosted many figures to suspiciously round numbers. Wanek also overstated his equity in the real estate he posted as collateral and listed some of his parents' assets as his own.

An attorney for Wanek, Mark C. Collins, says his client recreated the rent rolls—with Merrill's approval—only because his office had been burglarized and many records stolen 10 days before closing. "He prepared those numbers as best he could off the top of his memory," says Collins. "The proper due diligence wasn't done by anyone, but they want to make the buyer the scapegoat." Wanek, who filed for bankruptcy shortly before he lost the civil case in January 2006, now faces criminal fraud charges from the Franklin County prosecutor.

All told, Merrill and the lenders on Wanek's other properties have lost $38 million. His parents, two retired schoolteachers, had to file for bankruptcy as well. "Lenders were willing to underwrite on his record and the revenue stream of the property," says David D. Ferguson, an attorney who represented Merrill. "But it was a scheme doomed for failure." | BW |

—With John Cady in New York

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THE BEST B-SCHOOLS

A BRUTAL WAKEUP CALL

By Geoff Gloeckler

The economic crisis has hit executive MBA and non-degree programs hard, but the savviest are adapting to the new market



When Megan Lum enrolled in the MBA program for executives at the University of Washington's Foster School of Business last fall, her plan was to use the degree as a stepping-stone to the C-suite. Based on her career trajectory, that goal wasn't so farfetched. In 20 years she had worked her way up the corporate ladder to the role of senior environmental manager at Weyerhaeuser. The company thought so highly of her that it agreed to foot 80% of the bill for her EMBA, a nice perk considering the degree's $75,000 price tag. But just as Lum was starting classes the global economy went into a tailspin. Seven months later she was laid off. "Suddenly, I was without work, enrolled in an expensive EMBA program with no corporate support," says Lum, who has since found a job. Still, this wasn't part of the plan.

In fact, nothing about this year was part of the plan for a host of MBA programs that cater to working professionals and students like Lum. It has been a year of transition for executive MBA programs, which serve senior managers attending on weekends; part-time MBA programs, which allow mid-level managers to take courses on nights and weekends; and non-degree executive-education classes of a few days or weeks.

Once designed to give promising managers some high-level training and then return them to the corporate fold, part-time and executive MBA programs have been transformed entirely by the economic downturn. The generous corporate sponsorship Lum received is now more the exception than the rule, and far more students use the programs as transitions to new jobs or even new careers. As a result, students are expecting the kind of job-placement services usually reserved for full-time students to help them on their way. With virtually no programs offering such support, student satisfaction has plummeted across the board. Worse, applications are down dramatically for both types of programs, in large part because of reduced corporate support. Nearly half of all EMBA programs and part-time programs

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FOR PART-TIME B-SCHOOLS

reported a decrease in 2009, according to the Graduate Management Admission Council.

Non-degree executive-education programs have also taken a hit. Many corporate travel budgets have been slashed to the bone, and companies are sending fewer employees to expensive on-campus open-enrollment programs. Others have suspended the use of customized training courses—for many years a B-school cash cow—until the economy turns around.

In *BusinessWeek*'s 2009 ranking of the best executive MBA, part-time MBA, and executive-education programs, those that fared best are the ones that quickly adapted to these changing economic conditions. Each of the rankings is based solely or in part on surveys of the programs' main constituents: EMBA graduates and program directors, part-time MBA students, and compa-



ILLUSTRATIONS BY JULIEN PACAUD/COLAGENE.COM

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nies that enroll employees in executive-education courses. The best part-time and executive MBA programs were able to help students navigate the downturn with career support tailored to their particular circumstances, while the top executive-education programs were able to convince corporate clients that their courses are critical, even in today's tough financial climate.

In the EMBA ranks, the top three schools—Northwestern University's Kellogg School of Management, University of Chicago's Booth School of Business, and University of Pennsylvania's Wharton School—each tapped their faculty's corporate connections and extensive alumni networks to help students through a difficult job market. All three, which have held the top three spots since the ranking started in 1991, also benefited from spotless reputations for academic rigor, star-studded faculty, and high-caliber students.

Even so, all three programs dropped in student satisfaction compared with 2007, the last time *BusinessWeek* ranked EMBA programs. They weren't alone: Of the 83 EMBA programs in the 2009 ranking, only the University of Texas at Austin's McCombs School of Business boosted student satisfaction. With more students paying their own way, expectations are higher, and disappointments—over career services, faculty, accommodations, even food—are felt more sharply.

It's a change that was a long time coming but that picked up steam during the downturn as corporate support eroded further. "It's been a complete reversal," says David Springate, founder of the EMBA program at the University of Texas at Dallas.

These days fewer EMBA students feel the kind of loyalty to their companies they may have felt in the past, and many more expect their programs to help them find a job. This poses a problem for business schools, since most career offices are not accustomed to finding jobs for senior-level managers such as those enrolled in executive MBA programs. So administrators are seeking reinforcements.

At some schools, including Duke University's Fuqua School of Business (No. 10), INSEAD (No. 19), and University of Texas at Dallas (No. 22), this means partnerships with Web-based executive search firms—including Doostang,

TOP PART-TIME MBA PROGRAMS

Region	2009 National/ Regional Rank	School	Program Cost (per credit hour)	Average Salary Increase	Rated Best For:	Comments
NORTH-EAST	**1** / 1	**Worcester Polytechnic** Worcester, Mass.	$1,121	21.2%	Career Advancers	Students laud the technology focus and use of experienced adjunct professors, but would like more access to local businesses.
	22 / 2	**Boston University** Boston	1,184	36.3	Career Switchers	Professors with corporate experience are a real asset, but many students complain about the teaching quality in summer courses.
	23 / 3	**NYU (Stern)** New York	1,515	32	Career Switchers	Grads rave about Wall Street connections and luminary profs, but complain of a divide between full-time and part-time students.
	33 / 4	**Boston College (Carroll)** Boston	1,220	33.2	Career Switchers	Students say differences between part-time and full-time programs are indiscernible; both groups take electives together.
	55 / 5	**Fordham** New York	1,061	38.1	Job Changers/ Career Switchers	Smart faculty and part-time-friendly facilities are pluses, but grads expect more networking, considering the NYC locale.
WEST	**2** / 1	**UCLA (Anderson)** Los Angeles	1,100	24.8	Job Changers	Students say the part-time program has a familial atmosphere, with a strong alumni network and dedicated faculty.
	3 / 2	**UC Berkeley (Haas)** Berkeley	2,242	23.9	Career Switchers	Haas students laud the core curriculum and unique mid-program academic retreat; some complain full-timers get more attention.
	13 / 3	**Loyola Marymount** Los Angeles	1,076	38.6	Career Switchers	Tuned-in profs and small class sizes have students singing LMU's praises, though some wish the program were more challenging.
	19 / 4	**USC (Marshall)** Los Angeles	1,333	30.8	Career Switchers	USC boasts a strong alumni network and top professors, but part-timers complain that they're treated like second-class citizens.
	21 / 5	**Nevada** Reno	224	21.7	Job Changers	The program provides a good balance between theoretical and practical information. Profs are not always available outside of class.
MIDWEST	**4** / 1	**Nebraska** Lincoln	247	60.7	Job Changers	Class instruction and small size win raves from students, though some professors aren't up-to-date when it comes to technology.
	5 / 2	**Michigan (Ross)** Ann Arbor	1,398	44	Career Switchers	Courses that mix part-time and full-time students win raves. Class sizes could be smaller.
	9 / 3	**Indiana University Southeast** New Albany, Ind.	324	28.9	Job Changers/ Career Switchers	The program can't be beat for the bargain price, but some complain that the low cost sends a negative message about quality.
	12 / 4	**Chicago (Booth)** Chicago	NA	33.2	Career Switchers	Booth students say the program is overwhelming but well-worth the investment; some complain about course availability.
	14 / 5	**Case Western (Weatherhead)** Cleveland, Ohio	1,542	38.4	Career Switchers	Innovative, dynamic teaching in elective courses puts cut-and-dry core courses to shame; job placement resources are lacking.

Methodology Note: Rankings are based on three measures. A student survey, sent to 12,414 part-time MBA students at 99 programs by Cambria Consulting and completed by 4,222 (34%), measures general student satisfaction. An academic quality score consists of six equally weighted measures: average GMAT score, average work experience, the percentage of all teachers in the part-time MBA program who are tenured faculty, average class size in core business classes, the number of business electives available to part-time MBA students, and the program's completion rate. A third measure of post-MBA outcomes is based on the percentage of survey respondents who say their program was "completely" responsible for their achieving their goals. For this, we averaged the percentages for three categories of students:

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RiseSmart, and Ivy Exec—that specialize in helping ultra-experienced individuals find jobs. At University of Michigan's Ross School of Business (No. 7), an executive career coach helps EMBA students and alumni with job searches. And at the University of Alabama's Manderson Graduate School of Business, EMBA students create a personal career plan during orientation, before they set foot in a classroom. Career-services offices are also encouraging EMBA students to reach out to professional contacts, alumni, and even current students to assist in the search. "We tell our students that there is a tremendous group of people sitting in the room with you," says Susan West, assistant dean at Alabama. "Get to know them. You never know who might be aware of a job opportunity."

9%

Annual decline in applications to top-10 part-time MBA programs in 2009

Data: *BusinessWeek*

Economic forces reshaping the executive MBA world are taking their toll on part-time MBA programs as well. When the economy began to falter, interest in part-time MBA programs went up. B-school-hosted information sessions attracted standing-room-only crowds, and all signs pointed to a banner year for applications. But at Southern Methodist University's Cox School of Business (No. 15), Marci Armstrong, associate dean of graduate programs, was worried. "The mood at the sessions was very, very different," Armstrong says. "People had serious concerns about whether or not it was the right time to get an MBA. There were a lot of questions about costs and about the time commitment the program required." In the end, few prospective applicants wanted to put their jobs at risk by taking time off for classes. The result: Applications were flat. And not just at Cox. At the top-10 part-time programs, applications dropped an average of 9% compared with 2008.

One exception was Massachusetts' Worcester Polytechnic Institute, which snagged the No. 1 ranking this year. Because the program is small—fewer that 200 students—and focused on innovation and technology, grads say they get more attention from career staff and experience greater success on the job front than peers at other top part-time programs. Through visits to local companies, alumni networking events, and workshops with industry leaders, students make contacts that can advance their careers.

Like EMBA programs, part-time MBA programs saw a marked decrease in student satisfaction this year. In all, 80% of those participating in the ranking experienced a decline in

Region	2009 National/ Regional Rank	School	Program Cost (per credit hour)	Average Salary Increase	Rated Best For:	Comments
SOUTH	6 / 1	**Elon (Love)** Elon, N.C.	$550	18.8%	Career Advancers	Elon's accommodating, student-centered approach impresses grads; some complain about unprepared professors.
	11 / 2	**Emory (Goizueta)** Atlanta	1,300	36.4	Career Switchers	Small class sizes and close-knit community have students smiling; career services need improvement.
	18 / 3	**Belmont (Massey)** Nashville, Tenn.	1,145	21.9	Career Advancers	Students appreciate the small class sizes and access to professors, but many would like more time to focus on core topics.
	29 / 4	**Georgia State (Robinson)** Atlanta	338	27.2	Career Switchers	Robinson boasts a diverse student body and motivated, excited professors; some say excessive group work hinders success.
	32 / 5	**Wake Forest** Winston-Salem	615	23.2	Career Switchers	Part-timers have only good things to say about Wake, raving about everything from teaching and career placement to networking.
MID-ATLANTIC	7 / 1	**Carnegie Mellon (Tepper)** Pittsburgh	1,614	44	Job Changers	Tepper's small part-time program has a real family feel, but many complain about the lack of flexibility and parking.
	10 / 2	**Drexel (LeBow)** Philadelphia	915	24.9	Career Switchers	The "tough," "intense" program can be too much for some, but grads say the business principles learned are worth the hard work.
	17 / 3	**Richmond (Robins)** Richmond, Va.	940	47.5	Job Changers	Experienced students and faculty provide a top-notch learning environment. Some want more current trends incorporated into courses.
	30 / 4	**Maryland (Smith)** College Park	869	31.9	Career Switchers	Small class sizes and a focus on globalization are pluses, but some students say the price tag's a bit much.
	35 / 5	**Lehigh** Bethlehem, Pa.	840	18.2	Career Advancers	Students in Lehigh's program learn as much from their peers as from their professors. Classes need more global focus.
SOUTH-WEST	8 / 1	**Rice (Jones)** Houston	1,508	25.5	Job Changers	The rigorous curriculum and great professional network win praise, but administrative resources for part-timers are lacking.
	15 / 2	**SMU (Cox)** Dallas	1,512	32.9	Career Advancers	A myriad of networking opportunities, a mentorship program, and Dallas industry connections set SMU apart, students say.
	24 / 3	**Texas** Dallas	600	32.3	Job Changers	The comprehensive program exposes students to Dallas' local business community; too much class work is group-focused.
	28 / 4	**Texas** San Antonio	221	57.1	Career Switchers	Students call the program difficult but rewarding. Some would like to see more in-depth and current case studies.
	37 / 5	**Texas (McCombs)** Austin	1,745	22.2	Career Switchers	UT offers a good balance of research faculty and adjuncts with corporate experience. Some complain that group work is excessive.

"career advancers," who are looking for a promotion with their current employer; "job changers," who are looking to advance their careers with a new employer; and "career switchers," who want to change industries, functional areas, or both. The student survey contributed 40% of the final ranking, with the academic quality and post-MBA outcome measures contributing 30% each. Data on program cost provided by the schools. Average salary increase based on respondents to student survey. NA=not available. For additional information on our methodology visit our FAQ online at www.businessweek.com/bschools/faq/index.html.
Data: Cambria Consulting, *BusinessWeek*.

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2009 compared with 2007. The overarching complaint: lack of exposure to on-campus recruiting. The criticism is valid. Unlike full-time MBAs, who are courted by employers during on-campus recruiting events, part-timers are often excluded, either because of work conflicts or by the companies.

To deal with increased demand for career services, some schools have started offering career-management courses, as well as extended office hours for part-time students unable to meet with career advisers during the day. At SMU, first-year part-time students are able to take a not-for-credit career-management course. After completing it, students have full access to career services' offerings. In 2007, 25% of part-time students at Cox enrolled in the course. This year it was nearly everyone. "It's a dramatic change," Armstrong says.

Elsewhere, administrators at New York University's Stern School of Business (No. 23) were prepared to deal with increased demand for career support, thanks to an initiative begun during the last economic downturn. In 2003, in the aftermath of the dot-com bust and September 11, Pamela Mittman, assistant dean of career services, and her team opened the Career Center for Working Professionals (CCWP) after observing the challenges faced by part-time MBA and EMBA students looking to make 180-degree career changes. "We hadn't seen success in part-time students throwing their hat in the ring for typical [MBA-level] roles," Mittman says. "The delivery of career development needed to be different, more customized." Today the CCWP functions much like a full-time MBA career office, offering students with full-time jobs personalized career-management support. Mittman estimates that the office has conducted 1,500 one-on-one meetings in the past year, covering about half the student population.



Lum expected an EMBA would boost her to the C-suite. Instead, she lost her job

BRIAN SMALE

Change was afoot in the executive-education world as well. When the economy is booming, executive education is a lucrative business. But all that changed last year. With travel budgets slashed, fewer companies sent managers to "open-enrollment" non-degree programs, which typically last a few days or weeks on campus. Of the 188 companies that responded to the *BusinessWeek* survey, 25% reported sending fewer employees to open-enrollment programs this year vs. last. For custom programs, designed for specific corporate clients, the total is down 12%.

A SPOOKED NEW WORLD

Few top programs were spared. At INSEAD in Fontainebleau, France, revenues are down 15% for custom programs and 20% for open-enrollment. At Michigan's Ross School, participation dropped 30% compared with two years ago. And at the Center for Creative Leadership, open-enrollment revenue fell from $34 million in 2008 to $30 million this year. Even Duke Corporate Education, ranked No. 1 among custom programs, saw revenues drop 19%, to $56 million. "Several clients in the mining and materials industries were forced to cancel when commodity prices dropped," says Duke CE Chief Executive Gordon Armstrong. "We had several financial institutions cancel because of their distress."

Like many open-enrollment programs this year, Harvard Business School held on to its No. 1 ranking by focusing on strengths such as general management. In the custom category, Duke CE retained the top spot by doing what it does best: teaching complex business concepts such as leadership by combining classroom sessions with innovative activities requiring student participation. In the past year, 10,000 people from 65 companies participated in Duke CE's custom offerings, with price tags ranging from $200,000 to $1 million per program.

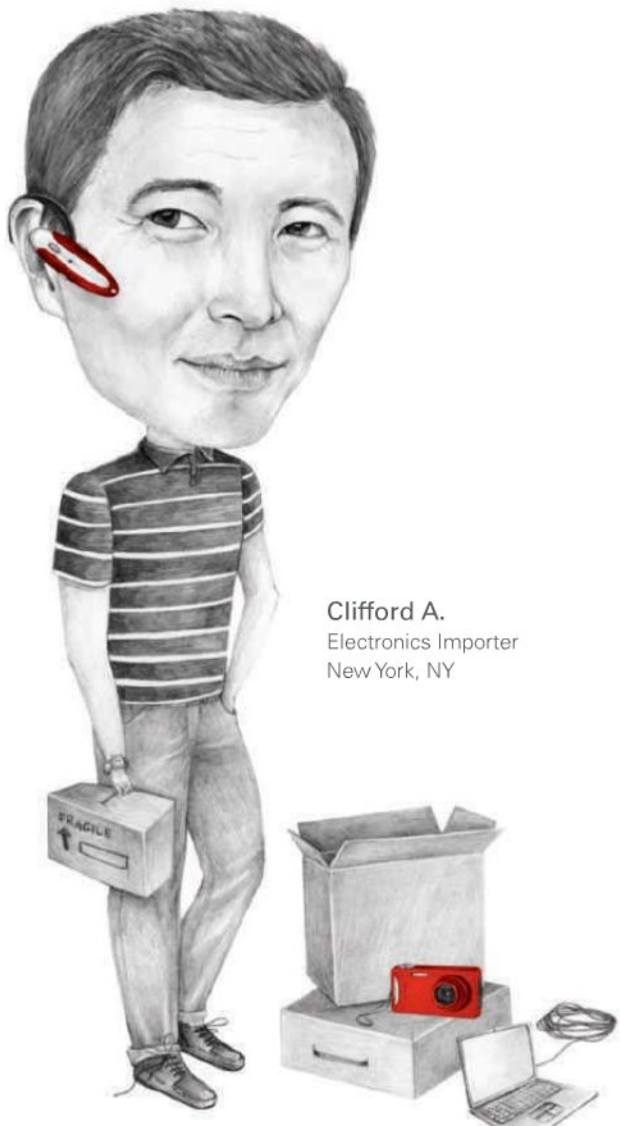
Even with its decline in revenues, Duke CE and outfits like it that focus solely on custom programs may be better positioned for the recovery than many business schools that offer both open-enrollment and custom programs. For many companies, low-cost custom programs that can be conducted at the workplace represent a far better value than expensive on-campus open-enrollment options.

Boston Scientific has shifted most of its training budget to custom programs developed by Wharton. Albert Siu, vice-president for learning and development at the medical-device maker, estimates that the total cost is a tenth that of open-enrollment programs. "When you have to manage costs, custom programs become the preferred mode of operation," he says. The credit-reporting agency Experian, for example, has halted all spending on open-enrollment programs. Custom programs are under the microscope, too, but for now the company is proceeding with one being developed by the Center for Creative Leadership. "I was faced with a lot of questions from our CEO and COO about whether we should go ahead with the plans we had been working on because of the economic environment," says Steve Hellman, vice-president for leadership and organizational development. "It's something that's of critical importance to our future growth, so we went ahead with it." |BW|

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TOP EXECUTIVE MBA PROGRAMS

For details on the ranking methodologies and full lists of all ranked schools, go to businessweek.com/go/09/bschools

2009/ 2007 Rank	School	Total Tuition	Grads' Yrs. Of Work Experience	Teaching	Support	Comments
1 / 1	**Northwestern (Kellogg)** Evanston, Ill.	$148,000	13.9	A	B	Students cheer about star faculty, strong networks, and free continued learning, but some wish for more practical coursework.
2 / 3	**Chicago (Booth)** Chicago	134,000	12.3	A+	B	The engaging faculty, experienced classmates, and global focus have Booth students singing the school's praises.
3 / 2	**Pennsylvania (Wharton)** Philadelphia	156,600	10	A+	A+	Wharton's reputation as an elite program rings true with EMBA grads, who rave about everything from logistics to class rigor.
4 / 6	**Columbia** New York	144,000	10	A	A	Students laud the finance-heavy program's focus on soft skills and leadership; some would like more general management.
5 / 5	**USC (Marshall)** Los Angeles	101,000	13.8	A	A	Marshall excels at providing students access to the alumni network in the classroom and out. School gets high marks for teaching.
6 / 15	**IE Business School** Madrid	77,000	14.5	B	B	The use of online discussions gets mixed reviews, but IE's international focus provides students with a truly global view.
7 / 4	**Michigan (Ross)** Ann Arbor	125,000	14	A+	A	Courses at Ross offer a good balance of case studies and faculty lectures, though some complain about large class sizes.
8 / 8	**UCLA (Anderson)** Los Angeles	101,265	12.8	A+	A	Students rave about international experiences in locations like Dubai and China. One complaint: Class sizes are too small.
9 / 11	**SMU (Cox)** Dallas	94,625	15	A	B	All-star faculty help offset some students' impressions that staff sometimes ignore student needs.
10 / 9	**Duke (Fuqua-Global)** Durham, N.C.	140,900	14.2	A	A	For GEMBA students, the world is their campus, literally. The program is intense—and some say too short—but worth the price.
11 / 10	**UNC (Kenan-Flagler)** Chapel Hill, N.C.	84,600	10.7	A+	A+	Integrated courses and top-notch faculty, paired with seamless logistics and planning, make class work students' only concern.
12 / 7	**Emory (Goizueta)** Atlanta	92,000	12.8	B	A	A close-knit community and responsive administration set Emory apart, though some complain about low admission standards.
13 / 17	**IESE** Barcelona	123,700	11.5	B	B	Students say the Barcelona campus is like going to school at a Four Seasons hotel. Grads complain about job placement abroad.
14 / 19	**NYU (Stern)** New York	137,000	14	A	A+	The experienced student body and strong finance bent give Stern an edge, but the high price tag sours some.
15 / 14	**Ohio State (Fisher)** Columbus	73,500	14	A	A+	OSU offers invaluable international exposure and accessible profs, students say, though it skimps on guest speakers.
16 / 16	**IMD** Lausanne, Switzerland	122,000	15	B	A	The small program allows for a good deal of discussion in class. Students like the diversity and experience of their peers.
17 / 21	**ESADE** Barcelona	90,500	15	A	B	The team-teaching approach allows for students to understand topics on both an academic and practical level.
18 / 12	**Georgetown (McDonough)** Washington, D.C.	105,000	13.1	B	C	Students rave about the dynamic in-class experience and overseas residencies, but many would like better access to career services.
19 / 18	**INSEAD** France/Singapore	126,697	10	A+	A+	The 14-month program lets students earn their MBA quickly, but some want more time to delve deeper into class topics.
20 / NR	**Notre Dame (Mendoza)** Notre Dame, Ind.	83,400	13.9	A+	B	A strong focus on ethics and principled leadership wins praise, but teachers are not universally loved.
21 / NR	**Case Western (Weatherhead)** Cleveland, Ohio	92,000	15	A+	A+	Students rave about the professors' ability to leverage students' business experience to advance class discussions.
22 / NR	**Texas** Dallas	75,000	14	B	A+	The case-study-heavy program helps students learn how to handle business problems. Lack of ethics teaching is off-putting to some.
23 / NR	**Boston University** Boston	79,500	16.5	B	A+	BU wins raves for attentive staff, but many students wish there were more time for discussion and electives.
24 / 20	**London Business School** London	78,228	10	C	C	Alumni network and diversity of classmates wins raves, but non-British students complain about limited elective offerings.
25 / 23	**Queen's** Kingston, Ont.	84,000	14.4	B	A	Students praise the coursework, but lack of international content and limited career services rankle some.

Methodology Note: Ranks are based on a survey of EMBA graduates and a survey of EMBA program directors. The graduate poll was sent to 5,056 students at 83 programs and 2,974 responded (58%); the director poll was sent to 83 directors and 69 responded (83%). The graduate survey consists of about 50 questions on teaching quality, career services, and curriculum, among other things. Using the average answer to each question, and each question's standard deviation, we calculate a 2009 student survey score for each school. The 2009 score is combined with two previous student survey scores (2007 and 2005) for a total student survey score which contributes 65% of the final ranking. The survey of EMBA program directors asks them to list their top 10 programs. No. 1 rankings are assigned 10 points, No. 2 nine points, etc. The point totals for each program contribute 35% of the final ranking. Letter grades are based on the 2009 graduate survey only. Each grade represents the average of all responses in each of the categories. Since the categories represent only a portion of the total graduate survey, highly ranked programs can have low letter grades while lower-ranked programs can have high letter grades. In each category, the top 20% earned an A+, the next 25% received A's, the next 35% were awarded B's, and the bottom 20% got C's. Tuition data was provided by the schools. Out-of-state tuition is used where appropriate. Grads' years of work experience is an average based on the 2009 student survey. NR=not ranked. For more on our methodology visit our FAQ online at www.businessweek.com/bschools/faq/index.html.

Data: Cambria Consulting, *BusinessWeek*

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OPEN ENROLLMENT

2009 Rank	2007 Rank	Provider/Location	Open Programs Offered	General Mgmt	Leadership	Strategy
1	1	**Harvard** Boston	61	A+	A	A+
2	2	**INSEAD** France/Singapore	40	A+	A+	A+
3	4	**Stanford** Stanford, Calif.	23	B	B	B
4	3	**IMD** Lausanne, Switzerland	20	A	A+	A+
5	NR	**Center for Creative Leadership** Greensboro, N.C.	12	B	A+	C
6	6	**London Business School** London	32	A	A	A
7	8	**Pennsylvania (Wharton)** Philadelphia	56	A+	A+	A+
8	7	**Michigan (Ross)** Ann Arbor	45	A	A	B
9	12	**IESE** Barcelona	151	A+	A	A+
10	13	**MIT (Sloan)** Cambridge, Mass.	22	C	C	A
11	14	**ESADE** Barcelona	57	A+	A+	A+
12	5	**Columbia** New York	30	A	B	A
13	18	**Northwestern (Kellogg)** Evanston, Ill.	63	B	C	B
14	16	**IE Business School** Madrid	117	A+	A+	A+
15	9	**Chicago (Booth)** Chicago	28	C	NA	B
16	10	**Virginia (Darden)** Charlottesville	21	B	B	B
17	NR	**Ashridge Business School** Berkhamsted, England	30	A	A	A
18	11	**Duke (Fuqua)** Durham, N.C.	8	NA	C	C
19	NR	**Queen's** Kinston, Ont.	20	A	B	B
20	17	**Thunderbird** Glendale, Ariz.	60	C	C	C

CUSTOMIZED CURRICULUM

2009 Rank	2007 Rank	Provider/Location	Custom Programs Offered
1	1	**Duke Corporate Education** Durham, N.C.	130
2	3	**INSEAD** France/Singapore	130
3	8	**Center for Creative Leadership** Greensboro, N.C.	422
4	10	**ESADE** Barcelona	99
5	2	**IMD** Lausanne, Switzerland	120
6	4	**Harvard** Boston	42
7	12	**IESE** Barcelona	178
8	13	**IE Business School** Madrid	98
9	11	**Pennsylvania (Wharton)** Philadelphia	126
10	18	**Michigan (Ross)** Ann Arbor	19
11	NR	**Babson (Olin)** Babson Park, Mass.	72
12	5	**London Business School** London	119
13	9	**Thunderbird** Glendale, Ariz.	137
14	16	**MIT (Sloan)** Cambridge, Mass.	19
15	20	**UNC (Kenan-Flagler)** Chapel Hill, N.C.	40
16	NR	**Northwestern (Kellogg)** Evanston, Ill.	62
17	14	**Stanford** Stanford, Calif.	22
18	NR	**Virginia (Darden)** Charlottesville	43
19	15	**Notre Dame (Mendoza)** Notre Dame, Ind.	22
20	7	**Columbia** New York	24

Methodology Note: Rankings were determined by the results of an online survey *BusinessWeek* sent to 809 companies; 188 responded (23%). Companies indicated familiarity with both university and private-sector providers and ranked them in order of best programs overall for both custom programs, designed for specific clients, and open-enrollment programs, which are open to all companies. A No. 1 ranking was assigned 10 points, No. 2 nine points, etc. To compute the ranking, the total score for a school/provider was multiplied by the number of companies ranking it and divided by the number of companies that indicated familiarity. Letter grades are based on the average of all responses in each of the categories. Since the categories represent only a portion of the total company survey, highly ranked programs can have low letter grades while lower-ranked programs can have high letter grades. In each category, the top 20% earned an A+, the next 25% received A's, the next 35% were awarded B's, and the bottom 20% got C's. NR=not ranked; NA=not available. For more on our methodology visit our FAQ online at www.businessweek.com/bschools/faq/index.html. Data: Cambria Consulting, *BusinessWeek*

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THE ACCIDENTAL HERO

Subway's $5 footlong, the brainchild of an obscure Miami franchisee, is the fast-food success story of the recession

By Matthew Boyle | Photography by Josh Ritchie

Stuart Frankel isn't what you'd call a power player in the world of franchising. Five years ago he owned two small Subway sandwich shops at either end of Miami's Jackson Memorial Hospital. After noticing that sales sagged on weekends, he came up with an idea: He would offer every footlong sandwich (the chain also sells 6-inch versions) on Saturday and Sunday for $5, about a buck less than the usual price. "I like round numbers," says Frankel, a brusque New Yorker who moved to Miami in 1972 and owned a drugstore before opening his first Subway outlet in 1988.

Customers liked his round number, too. Instead of dealing with idle employees and weak sales, Frankel suddenly had lines out the door. Sales rose by double digits. Nobody, least of all Frankel, knew it at the time, but he had stumbled on a concept that has unexpectedly morphed from a short-term gimmick into a national phenomenon that has turbocharged Subway's performance. "There are only a few times when a chain has been able to scramble up the whole industry, and this is one of them," says Jeffrey T. Davis, president of restaurant consultancy Sandelman & Associates. "It's huge."

In fact, the $3.8 billion in sales generated nationwide by the $5 footlong alone placed it among the top 10 fast-food brands in the U.S. for the year ended in August, according to NPD Group. That puts the $5 menu's success just a notch behind KFC and ahead of Arby's and Domino's Pizza. It helped privately held Subway, of Milford, Conn., lift U.S. sales 17% last year at a time when most restaurant chains, save for industry leader McDonald's, struggled. Actually, make that soon-to-be-former industry leader McDonald's. Subway's low-cost franchising model and mainstream appeal have allowed it to add 9,500 locations in the past five years, for a total of about 32,000 outlets. At its current growth rate of 40 new stores a week, Subway is poised to surpass McDonald's in worldwide locations sometime early next year. (Measured by total sales, McDonald's $30 billion still dwarfs Subway's $9.6 billion, although Subway has now supplanted both Wendy's and Burger King in market share.)

"A LIFE OF ITS OWN"

Frankel's $5 footlong idea illustrates how a huge company can wake up and eventually seize on a good idea that's not generated at headquarters. Frankel, along with two other local managers in economically ravaged South Florida, ceaselessly championed the idea to Subway's corporate leadership amid

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South Florida franchisee Frankel started the $5 footlong craze

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widespread skepticism. Once it was approved, Subway's marketing team quickly generated a memorable campaign that firmly established the $5 footlong nationwide. The promotion's success spawned imitators and created an unprecedented demand for staple ingredients such as turkey, ham, and tuna. "The whole thing took on a life of its own," says Jeff Moody, CEO of Subway's franchise-owned advertising arm, the Subway Franchisee Advertising Fund Trust.

The fact that a sandwich, the quintessential American food, has grabbed the spotlight right now comes as no surprise to some. Its appeal goes beyond the low sticker price—you can share a footlong with a co-worker or a friend (something that's not quite as easy with a Big Mac). "People are not eating out as much anymore, so anything that brings people together through food is much more compelling nowadays," says Michelle Barry of the Hartman Group, a Seattle consultancy that employs anthropologists and sociologists to ferret out consumer perceptions for such companies as Kraft Foods and Wal-Mart Stores.

For Frankel, the biggest surprise from his $5 promotion was that his profit margins didn't decline. Many promotions are so-called loss leaders designed to draw customers in the hope they'll buy higher-margin items alongside the featured special. That's one reason most offers have a time limit. Frankel's food costs did rise as a percentage of sales, but that was offset by the overall boost in volume and the increased productivity of his employees, who had less down time. Even after adding two new staffers, Frankel made money on each $5 sandwich.

$3.8 billion

Sales of Subway's $5 footlong sandwiches*

*Year ended August 2009
Data: The NPD Group/Crest

Frankel kept the weekend promotion going for more than a year. At the same time, Subway's top brass was growing tired of a national ad campaign that featured spokesman Jared Fogle, who had lost 245 pounds almost a decade earlier by eating Subway six-inch subs for lunch and dinner. Company insiders envied the success of McDonald's dollar menu and wanted a "value" offering of their own. In September 2007, Steve Sager, a Subway development agent who oversaw about 225 franchises across South Florida, heard about the success of Frankel's $5 deal. He decided to try it in a troubled Fort Lauderdale outlet on Commercial Boulevard, a gritty thoroughfare dotted with strip malls. On the first day of the promotion, the store nearly ran out of bread and meat. Sales doubled.

Sager called Subway co-founder Fred DeLuca, who lives in the vicinity, and excitedly shared the news. An intrigued DeLuca came by the shop and, Sager says, "saw the potential instantly." (DeLuca declined to comment.) Charlie Serabian, the owner of 50 South Florida Subways, decided to launch the promotion in some of his stores. To advertise, he slapped crude homemade signs in the windows that spelled out "ALL FOOTLONGS $5." DeLuca joked that they looked like ransom letters. It didn't matter: Sales rose as much as 35%. Some locations, such as those housed inside Wal-Mart stores, did even better.

Moody, the marketing chief, hopped a flight to Fort Lauderdale a month later. He arrived at one store at 11 a.m. to find a line out the door. Frankel and Sager, who accompanied him, jumped behind the counter to help make sandwiches, while Moody talked to customers. Most were buying footlongs, and some were saving half for later.



Sager alerted Subway's top brass to the potential

Clearly, the South Florida crew was onto something. The question was whether it would resonate elsewhere. "Unless it was in your store, you were skeptical," Moody says. At a meeting of the franchisee marketing board that fall, Frankel presented his idea. Many owners thought the promotion would send food and labor costs soaring, erasing any hope of profits. A motion to roll it out nationally failed.

ANNOYING JINGLE

But others picked up on Frankel's idea and tried it in locations ranging from Washington to Chicago. Right before Christmas 2008, the board voted again, and the motion passed. (Franchisees still had the option to not do it.) Moody pushed ahead with a national campaign, despite having no market research to back up the idea. "It violated all our normal processes," says Moody, whose annual ad budget is around $500 million.

Subway soon brought in its ad agency, MMB of Boston. "Let's not overcomplicate this," MMB managing partner Chad Caufield recalls thinking. The idea was to use hand ges-

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Serabian's sales swiftly climbed as much as 35%

tures and an irritatingly addictive jingle to convey both the price (five fingers) and the product (hands spread about a foot apart). MMB also shot on a soundstage, giving the commercial a stylized, campy look. "We wanted to create the feeling that this was a movement taking hold," Caufield says.

The campaign was launched on Mar. 23, 2008—the same month that Bear Stearns collapsed into the arms of JPMorgan Chase. "The timing could not have been better," says Lombardi, the restaurant consultant. Over the first two weeks, franchisees reported that sales shot up 25% on average. Within weeks, 3,600 videos of people performing the jingle appeared on YouTube. Fogle, attending the NCAA Final Four college basketball tournament soon after the launch, was serenaded with the song by students. The $5 footlong was mentioned on ESPN, *The Tonight Show*, and celebrity gossip site TMZ. The North Carolina State Fair even held a $5 Footlong Song Challenge—an *American Idol*-style event for the 4-H crowd.

The franchisee marketing board quickly voted to extend the four-week promotion to seven weeks. When that ended, Subway kept it going but limited the number of $5 sandwiches to just eight, removing items with high ingredient costs, such as the Chicken & Bacon Ranch sandwich.

Suddenly Subway needed 50% more food supplies. Bread shortages became a problem, as the ratio of six-inch sandwiches to footlong orders, normally 2 to 1, flipped. Subway's franchise-owned Independent Purchasing Cooperative, or IPC, had to scramble to find new sources of bread. Even mundane items, such as plastic sandwich bags from China, nearly ran out. "I was in a panic," recalls IPC CEO Jan Risi, who furiously worked the phones, cajoling her network of suppliers to run extra shifts.

EVEN CHEAPER

Soon, copycat offers emerged. Boston Market offered 11 meals for $5 each, while Domino's sold sandwiches for $4.99 and KFC launched $5 combo meals. T.G.I. Friday's began selling $5 sandwiches. "Five dollars is the magic number now," says restaurant consultant Malcolm Knapp. "It's become a price point that consumers respond to," says Judy Cantrell, Boston Market's chief brand officer.

The question now is when the campaign will run out of steam. MMB's Caufield admits the issue keeps him up at night: "Are we riding this pony too long?" Tony Pace, a senior executive who works with Subway's marketing arm, replies bluntly: "If you had a brand that represented nearly $4 billion in sales, would you plan an exit strategy for it?"

Pace says the footlong will remain "as long as it makes good economic sense," so a decline in footlong sales could force price hikes, or limits such as $5 after 4 p.m. (Serabian has gone the other way as the South Florida economy has worsened, offering footlongs for $4 in his stores.) There are also concerns that Subway's focus on the footlong could distract it from new growth areas, such as a planned push into breakfast items or international expansion. (Save for some tests in Australia and Canada, the $5 footlong hasn't gone beyond the U.S.)

Meanwhile, Frankel has moved on to a new idea. Now he's pushing for Subway loyalty cards that let purchasers accrue points toward free sandwiches. Driving down Interstate 95 toward Jackson Memorial on a cloudy autumn day, Frankel chronicles the frustrations he's had convincing DeLuca and others that this could be a hit. Maybe now that Frankel is the Father of the $5 Footlong, they'll listen. | BW |

BUSINESSWEEK.COM | For a video report on Subway's $5 footlong, go to businessweek.com/go/09/subway

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No Wait for a Table

Customer traffic in the $566 billion restaurant industry fell 3.6% this summer vs. last, says researcher NPD Group. Even fast-food chains, which took business from sit-down restaurants early in the recession, are seeing sales slide as unemployment continues to rise. Visits to fast-food outlets dipped 3%, the worst summer in decades.

To view the NPD report, go to **http://bx.businessweek.com/restaurant-industry/**

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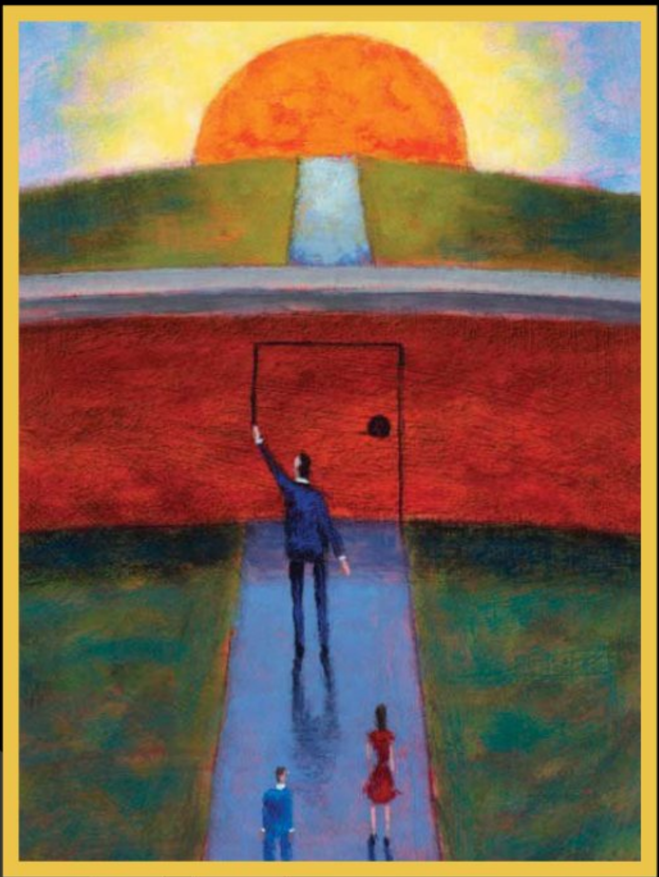
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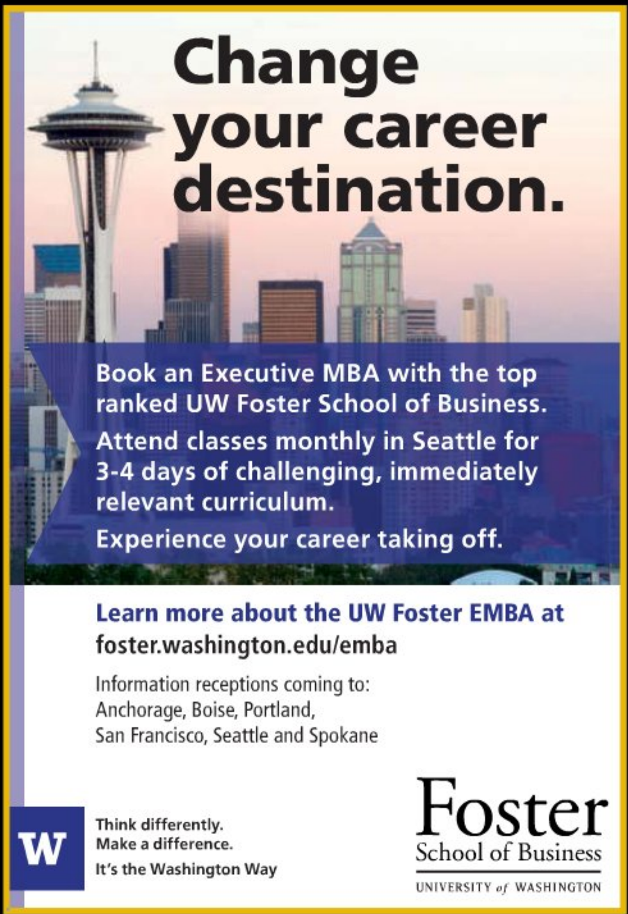


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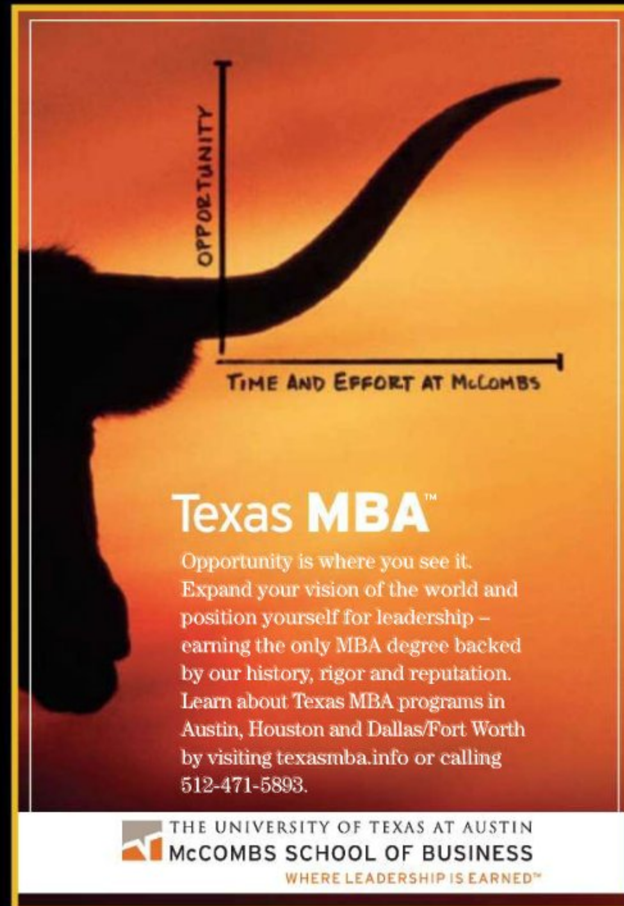
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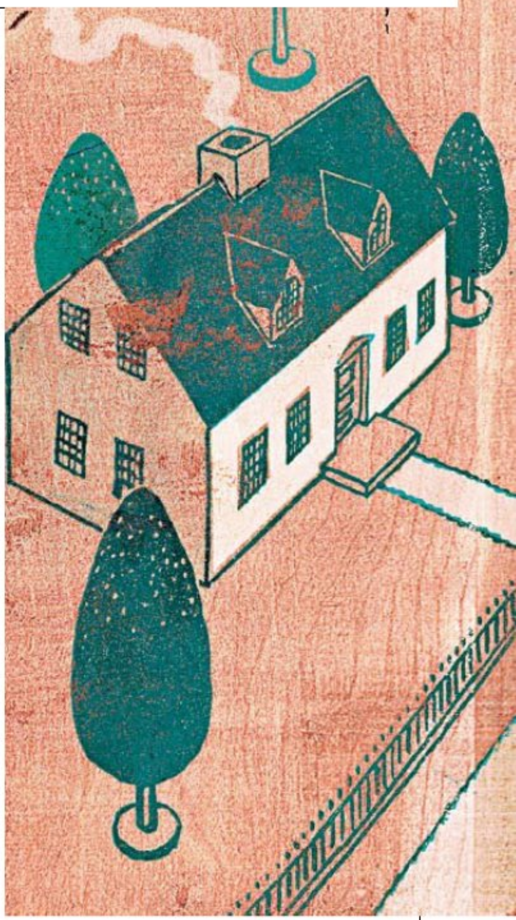
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072 The corner office or the highway
073 The war over FedEx drivers
074 Spain goes abroad for growth
076 Business incubators grow up
078 The side effects of drug ads
080 KeyOn's unusual stock gambit

MANAGEMENT & LEADERSHIP

The Return of The House Call

Companies eager to cut health-care costs may do well to consider the home doctor visits Microsoft offers



ACME ILLUSTRATORS

By Michelle Conlin

With health-care reform dominating Washington, policy analysts and benefits experts are looking at every possible cranny to unearth new, futuristic ways to slash costs. Yet one innovation that has captured their imaginations actually comes from the dusty, predigital past. The Obama Administration has been keeping a close eye on Microsoft, which, in a bid to slash costs, improve employee health, and even contain potential pandemics such as swine flu, has brought back the old-fashioned doctor's house call for employees. House calls appear in the proposed health-care reform package pending before Congress, and President Barack Obama himself has hailed them as one of the private sector's "terrific innovations."

Microsoft is one of the only, and by far the biggest, employers that is offering such white-glove, concierge-like service to workers. "The program," says CEO Steve Ballmer, "is an example of the importance the company has always put on its people." The Microsoft template doesn't make sense for every company. But for those with big concentrations of employees in densely packed locales—think of the 40,000 Microserfs and their 58,000 dependents in the Puget Sound area alone—the long-term rewards and savings can be substantial.

35%

Approximate savings when Microsoft pays a doctor to make a house call in lieu of the worker visiting the ER

Data: Microsoft

The Microsoft house call program, called Mobile Medicine, got its start in 2006 after a massive analysis of the company's health-care data. The team discovered that employees, like those at most companies, were using the emergency room mostly for non-life-threatening problems such as ear infections, skeletal bruises, and the flu.

Microsoft was already offering the Maserati of health plans. Employees usually don't pay a dime for a bevy of luxe offerings, including a weight-loss program that comes with personal coaches, behavioral therapists, and private dressing rooms in the gym to avoid locker room embarrassment. The goal behind the comprehensive health bennies is radical prevention: that it is cheaper to attack employees' health problems early rather than allowing them to metastasize into chronic, even costlier diseases.

COMPELLING SAVINGS

After realizing how many employees were using the ER for basic maladies, the company figured there had to be a better and cheaper way of doing business. "We didn't just want to say to people, 'Don't go to the ER,'" says

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Julie Sheehy, Microsoft's wellness and productivity chief. "We wanted to get at the reasons why they were going to the ER and address those issues."

At the time, a Seattle medical company called Carena was exploring different delivery models for medical care. Carena was already dispatching family doctors for visits on-site at companies including Starwood and Costco. Why not get Carena doctors to make Microsoft house calls?

Today, Carena physicians make some 350 house calls a month to Microsoft's Seattle employees. At a time when most natives in cubicle land are watching their employers whack benefits, Microserfs are having family doctors show up at their bedsides in the dead of night, sometimes even wearing a white lab coat and carrying a little black bag. The math makes a lot of sense for Microsoft. Trips to the emergency room average $1,500 a visit, according to the American Academy of Home Care Physicians. That's the cost of 10 house calls. Microsoft says the "housepitalists" are shaving approximately 35% off average ER bills, which make up the fastest-growing portion of health-care costs.

The strategy is part of a movement to give primary-care docs more responsibility to manage patients' treatments. The argument is that by getting more time with a doctor—perhaps even online—patients will be healthier in the long run. House calls enable doctors to examine patients in the context of their homes—a gold mine of clues.

Because home visits typically last up to an hour, compared with the 10 minutes most Americans are lucky to get at the doctor's office, studies show that physicians are better able to identify the underlying causes of a complaint and target which family members may be at risk. The doctors also serve as ambassadors to Microsoft's health plan, often signing patients up with a primary-care doctor on the spot.

What's more, house calls are playing an important role in health emergencies. Far better, Microsoft figures, to treat people for swine flu in their own homes than have them travel to the workplace, a hospital, or a doctor's office and infect others. "This isn't just a good benefit, it's an incredible benefit," says Microsoft attorney Ronald Rice, whose 5-year-old son recently saw a house call doctor for swine flu. "I recommended it to three of my co-workers whose kids also had flu symptoms."

The Carena doctors, who recently began making house calls to employees of Seattle-based Drugstore.com, have portable labs in their cars. That means they can turn a kitchen counter into a mini-clinic, capable of doing anything—strep throat culture, stress test—that can be done in a doctor's office. Christine Bennett, a Microsoft senior content manager, recently woke up in the middle of the night and discovered that her eyes had swollen shut. "I would have had to take my two kids and my husband, our whole family, to the ER," she says. Her husband called the help line. Within half an hour a doctor was at Bennett's side, diagnosing an eye infection and handing her an antibiotic. Says Bennett: "We were all back to sleep within two hours."

Private insurers, hospitals, and the Medicare program have all experimented with house calls for the elderly and chronically ill. The Independence at Home Act pending before Congress would increase the use of house calls for Medicare beneficiaries. Microsoft's Sheehy has also been inundated with requests from other companies who want to learn more. Says Sheehy: "It's kind of an old-fashioned idea, so people sometimes find it hard to grasp that it could be the way of the future." |BW|

Business Exchange

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Pity the Doctors

The Centers for Disease Control & Prevention last month advised employers to do away with requirements that workers who have experienced flu-like symptoms provide a doctor's note prior to returning to the workplace. The CDC claims such policies are a burden on physicians who are already overwhelmed by the H1N1 flu pandemic.

To view the CDC guidance, go to **bx.businessweek.com/swine-flu/reference/**

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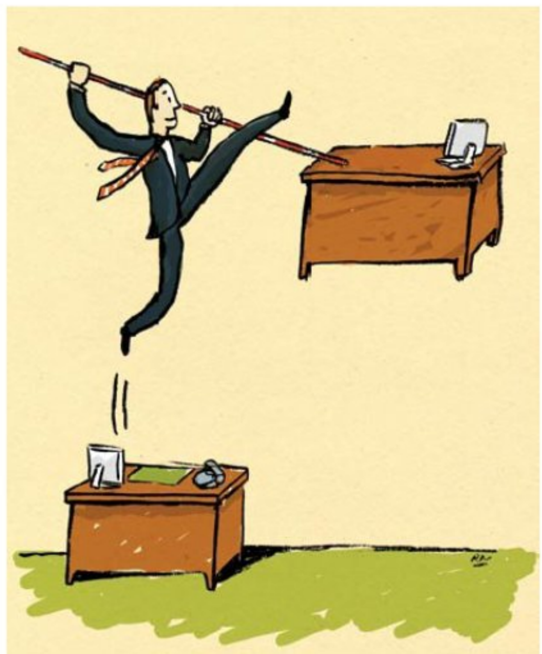
The Corner Office Or the Highway

Top executives are unapologetically quitting, with no sure thing in hand. Their stated goal? To be a CEO

By Jena McGregor

When Liam McGee departed as president of Bank of America in August, his explanation was surprisingly straight up. Rather than cloak his exit in the usual murky euphemisms, he came right out and said he was leaving "to pursue my goal of running a company." Broadcasting his ambition was "very much my decision," McGee says. Within two weeks, he was talking for the first time with the board of Hartford Financial Services Group, which named him CEO and chairman on Sept. 29.

Whether or not his candor clinched the job, McGee says leaving without a position lined up gave him time to reflect on what kind of company he wanted to run. It also sent a clear message to the outside world about his aspirations. And McGee isn't alone. In recent weeks the No. 2 executives at Avon and American Express quit with the explanation that they were looking for a CEO post. On Nov. 3, about six weeks after announcing her exit from Avon, Elizabeth Smith was named CEO of OSI Restaurant Partners, owner of such casual dining chains as Outback Steakhouse and Carrabba's Italian Grill. As boards scrutinize succession plans in response to shareholder pressure, executives who don't get the nod also may wish to move on. A tumultuous business environment also has senior managers wary of letting vague pronouncements cloud their reputations.



ROBERT NEUBECKER

As the first signs of recovery begin to take hold, deputy chiefs may be more willing to make the jump without a net. In the third quarter, CEO turnover was down 23% from a year ago as skittish boards stuck with the leaders they had, according to Liberum Research. As the economy picks up, says Russell Reynolds Associates recruiter Anne Lim O'Brien, "opportunities will abound" for aspiring leaders.

Many recruiters say the old stigma is fading—the financial crisis has made it more acceptable to be between jobs

The decision to quit a senior position to look for a better one is unconventional, to say the least. For years executives and headhunters have hewed closely to the rule that the most attractive CEO candidates are the ones who must be poached. Says Korn/Ferry senior partner Dennis Carey: "I can't think of a single search I've done where a board has not instructed me to look at [sitting CEOs] first."

A FADING STIGMA

Those who jumped without a job haven't always landed in top positions quickly. Ellen Marram quit as chief of Tropicana when the business became part of PepsiCo a decade ago, saying she wanted to be a CEO. Although Marram says she had "a lot of opportunities presented" to her, it was a year before she became head of a tiny Internet-based commodities exchange, efdex. Robert Willumstad left Citigroup in 2005 with ambitions to be a CEO. He finally took that post at a major financial institution three years later, briefly becoming CEO of American International Group three months before its near-collapse.

Many recruiters say the old stigma is fading for top performers. The financial crisis has made it more acceptable to be between jobs or to leave a bad one. "The traditional rule was it's safer to stay where you are, but that's been fundamentally inverted," says one headhunter. "The people who've been hurt the worst are those who've stayed too long."

The question is how quickly these ambitious managers can land on top. Smith's search didn't take long; neither did McGee's. When debating whether to leave, he reached out to colleagues, CEOs, and headhunters. Their advice, he says: "If you're viewed as good, it actually might be a positive thing. It shows you have the independence and self-confidence to go for what you want." |BW|

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MARK PETERSON/REDUX

Contractor? A FedEx Ground delivery worker on the job in Dayton, N.J.

ECONOMICS & POLICY

They're Employees. No, They're Not

The feud over Fedex's "contractors" hints at battles to come involving the classification of workers

By Michael Orey

Get ready for an intense new round in the long-running fight over which workers are independent contractors.

Hard economic times have prompted some employers to classify more members of their labor forces as contractors. That way the companies don't have to dole out benefits or pay taxes on workers' wages. Workers, of course, often want those benefits, and financially strapped government bodies are desperate for the tax revenue.

For years, shipping giant FedEx has been at the center of this fracas because it treats 12,000 package deliverers in its FedEx Ground Div. as contractors. The company's current situation illustrates how murky the legal waters on this issue can get.

On Oct. 20 the attorneys general of New York, New Jersey, and Montana threatened to sue FedEx if it doesn't reclassify the 12,000 delivery people as full-time employees. The states say they are owed millions in payroll taxes and that FedEx workers deserve fringe benefits befitting full-time employees.

But just 10 days later the IRS announced that it was reversing a $319 million tax assessment against FedEx that had been based on the allegation that the company misclassified drivers as contractors. The IRS won't explain its action—and FedEx won't comment—but for federal tax purposes the drivers now appear to be independent contractors after all.

Making matters even more complicated, even as the IRS let FedEx off the hook, the agency said it is taking a closer look at other companies that use contractors. The IRS announced that, starting in February, it will undertake extensive audits of 6,000 yet-to-be-named companies, in part to review employee classification. Meanwhile, lawmakers in several states—including New York, Maryland, Washington, Colorado, and Minnesota—have recently passed laws tightening rules over contract workers in an attempt to protect individuals and keep tax money flowing to state coffers.

MORE CONTRACTORS AHEAD

The legal definition of a worker turns on how much control a company has over the person: The more control, the more likely the individual will be considered an employee rather than a contractor. Littler Mendelson, a large law firm that represents employers, predicts that half of all Americans who are rehired after being laid off in the

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current downturn will return as "contingent" workers, such as contractors or temps.

Studies show contractors cost up to 30% less than payroll employees, mainly because they have to pay for their own benefits and employment taxes. They also aren't covered by most workplace laws, such as those related to discrimination and medical leave.

Companies that don't rely heavily on contractors criticize the practice. United Parcel Service, where drivers are unionized employees, complains that FedEx's policy is, in the words of spokesman Malcolm Berkley, "unfair to taxpayers, competitors, and the workers themselves."

Counters FedEx spokesman Maury Lane: "If the model weren't so successful, they wouldn't be so virulent to try to stop it." As for the comparisons of how much contractors cost vs. employees, FedEx Ground spokesman Perry Colosimo says the figures are "purely speculative, as we have no plans to classify FedEx Ground contractors as employees."



Route owner Skiptunis: "If something bad happens, I take a hit [financially]"

FedEx inherited its independent workforce in 1998, when it acquired the trucking company once known as Roadway Package System. Most of the company's 275,000-plus workers are employees.

FedEx describes its delivery contractors as thriving entrepreneurs. The company points to Ray M. Skiptunis, with nine routes in New Jersey, as an example. Skiptunis, who employs 15 people, says he feels every bit the independent businessman: "I'm at risk financially. I have $300,000 to $400,000 worth of equipment, and if something bad happens, I take a hit."

But critics claim most FedEx Ground drivers are fully controlled by the company. FedEx effectively has say over everything from uniforms to how many packages are delivered. And they face restrictions on working for rivals. | BW |

STRATEGY & COMPETITION

Spain: Seeking New Worlds to Conquer

Flush with cash and facing hard times at home, Spanish companies are again looking abroad

COUNTRY REPORT

By Mark Scott



BARCELONA

The Great Recession has been easy on Enric Casi. In fact, the general manager of Mango, Spain's No. 2 fashion retailer, can barely keep up with business. The 53-year-old Barcelona native has inaugurated 225 stores since the crisis began and anticipates launching an additional 200 annually in coming years, mostly abroad. Since January he has traveled repeatedly to Asia to open outlets and cut deals with suppliers. And in May he jetted off to Munich to celebrate a promotional deal with Scarlett Johansson. "The crisis has affected us, especially in Spain, but it's an opportunity to expand into other global markets," says Casi. The frenetic pace has paid off: Sales are on track to jump 10% this year, to some $2.3 billion.

Mango's story isn't a one-off. Spanish companies from windmill makers to banks to bicycle manufacturers have been flexing their financial muscle just as American and European rivals cut back. Last year, Madrid's Banco Santander, Europe's second-largest financial house, paid $1.9 billion for Sovereign Bancorp in the U.S. and $16 billion for Brazil's Banco Real. Retail giant Inditex, owner of fashion brand Zara, in February penned a deal with India's Tata Group to open stores across the subcontinent. And Iberdrola Renovables, already America's No. 2 wind farm developer, has won $546 million in U.S. federal grants—more than half of Washington's stimulus spending for green-energy projects.

It's a return to form for Iberia Inc. Two decades ago, Spain's biggest companies roared onto the global stage, expanding their operations and buying up rivals, initially in Latin America and later across Europe, Asia, and North America. But as the Spanish economy blossomed over the past eight years, many key players refocused their energy at home, where easy credit fueled consumer spending and a housing boom. Now, with unemployment at 19.3% and Spain's economy expected to contract 3.2% this year, the cream of the corporate crop is again looking abroad to jump-start growth. "Large Spanish companies know how to win overseas," says Xavier Vives, a professor at IESE Business School in Barcelona. "The Spanish economy won't pick up anytime soon, so they have little choice but to focus on international markets."

FEWER TOXIC ASSETS

Despite the turmoil at home, Spain's biggest companies are in surprisingly good shape. Most dodged the worst excesses of the pre-credit-crunch era, so they have stronger balance sheets and fewer toxic assets than do international rivals. And a long track record in developing markets will likely be an advantage as these outfits look farther afield for growth. Investors agree. The IBEX 35 index of Spain's leading stocks has risen 24%

HOW TO PLAY IT 084

MARK PETERSON/REDUX

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MARK GREGORY PETERS

Mango's Casi. The retailer sees the crisis as an opportunity to expand

this year, vs. 16% for the Standard & Poor's 500-stock index. And the foreign investments of Spanish multinationals have averaged $87 billion annually since 2007. That's 5.8% of Spain's gross domestic product, roughly the same level as in the late 1990s, vs. 4.3% earlier this decade.

Telefónica, the pioneer in Spain's previous push abroad, is again leading the way. As the former state monopoly carrier, the company had loads of cash when telecommunications deregulated in the 1990s. After dozens of deals over the past decade, Telefónica has become the largest phone company in Latin America and the third-biggest (in terms of customers) on earth. Since 2003, though, Telefónica has had to fend off growing competition at home, and has invested some $13 billion in domestic broadband and cable TV. Now, with the Spanish economy in the dumps, Telefónica is redoubling its efforts abroad. In September it sealed a $2 billion strategic alliance with Chinese wireless player China Unicom to gain a foothold in the mainland. On Oct. 7, Telefónica offered $4 billion for Brazilian broadband provider GVT, and it's in the running to buy HanseNet, a German Internet player owned by Telecom Italia. "You need to diversify," says Luís Abril, a member of Telefónica's executive committee. "You can't be too dependent on one market."

The country's second-largest bank, BBVA, is renewing its overseas efforts, too. After its acquisition of Bancomer in 2000 made BBVA the largest bank in Mexico, the Spanish company took advantage of the growing appetite for credit at home. Now it's again looking at new markets. In June 2008, BBVA paid $1.2 billion to double its stake in China Citic Bank, the mainland's seventh-largest, to 10.1%, with an option to boost that to 15% next year. And to strengthen its presence in the U.S., BBVA last summer bought distressed Texas lender Guaranty Bank, gaining $13 billion in assets. Further acquisitions across the southern U.S. are likely. "We want to saturate the Sunbelt," BBVA's chief strategist Carlos Torres says from his office overlooking the ornate 19th century facades along Madrid's Paseo de la Castellana.

CLEANING UP ON GREEN

Spain's long-established clean-energy companies are also getting in on the action abroad. Although they weren't a big part of the earlier overseas investment boom—most barely existed in the 1990s—they have benefited mightily from Madrid's subsidies for renewables. In recent years, Spain's green-energy sector has thrived as Spanish law has guaranteed above-market rates to providers of wind, solar, and other clean power. As politicians now seek to rein in costs, those subsidies have been trimmed. But Washington's green-tinted $787 billion stimulus package has offered some relief.

Chomping at the bit is Gamesa, the world's No. 3 wind turbine manufacturer. The company already employs more than 1,100 Americans, and 17% of its $2.4 billion first-half sales came from the U.S., its second-largest market. It's also diversifying into China, where it owns four wind turbine plants near the port city of Tianjin, and India, where it has a joint venture with conglomerate Pioneer Asia. "Spain has been good to us," says Michaela O'Donohoe, Gamesa's chief of corporate affairs. "But the major growth will now come from overseas." |BW|

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Business Incubators Are Growing Up

They're broadening their reach to include more tech-savvy, time-pressed entrepreneurs

By Anne Field

SMALL BIZ

Bill Shander knows how to start a business. He opened Beehive Media in Chelmsford, Mass., 15 years ago. The six-employee, $3 million Web design group boasts such clients as PricewaterhouseCoopers and the University of Chicago. But last year, when Shander started exploring an idea for a company that would allow people to merge their online and offline identities yet control the information available about them, he felt he was entering foreign territory. "I never did a startup where we launched our own product," Shander says. "It's a whole different beast."

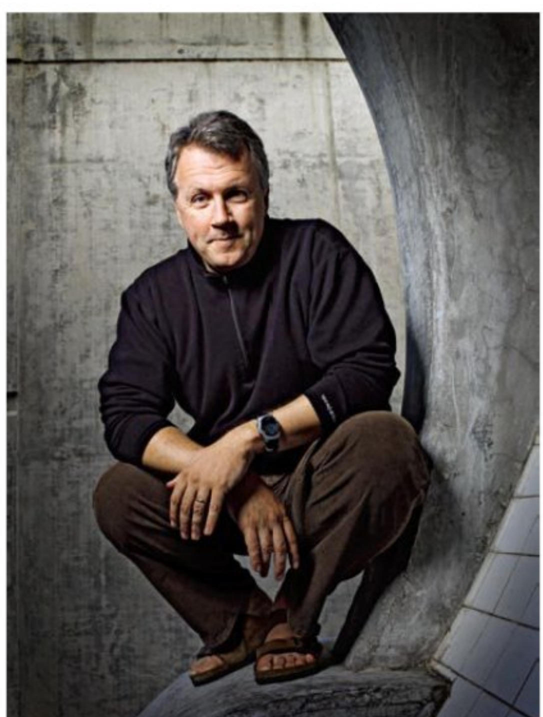
An inexperienced entrepreneur might logically have turned to a business incubator for startup advice. Surprisingly, that was also the best route for veteran Shander, who signed on with a new incubator that lets busy founders participate online.

Incubators, like the companies they support, are evolving to accommodate a tech-savvy clientele and startups with new priorities. Some offer novel models for delivering their services; others target socially responsible businesses. "I see a lot of experimentation going on these days," says Dinah Adkins, president emeritus of the National Business Incubation Assn. in Athens, Ohio.

PRODUCTION-LINE ADVICE

Many incubators are taking advantage of the expertise of a generation of successful entrepreneurs who have cashed out and are eager to pass on their experience. Y Combinator, co-founded by Paul Graham in Mountain View, Calif., in 2005, is probably the best known. The incubator—Graham prefers "venture accelerator"—works on the premise that it's possible "to apply mass-production techniques to the founding of a startup," or at least to Web startups, he says. Y Combinator enrolls about 10 Web startups in its three-month program, giving each $15,000 in exchange for a 6% equity stake. Entrepreneurs work at the Y Combinator offices and get weekly dinners with a startup expert and regular meetings with Graham and other founders. In week 10, each team pitches to investors. Similar venture accelerators have sprung up in Philadelphia, Phoenix, and Atlanta.

Y Combinator's Graham says his incubator likes to help founders of Web startups



ROBYN TWOMEY

The roughly 40,000 entrepreneurs who run so-called double- or triple-bottom-line businesses—which seek to create benefits that are explicitly social, or environmental, or both—encounter unique challenges. These include measuring progress toward social goals and setting up employee ownership plans.

Enter the social business incubator. The Business Accelerator for Sustainable Entrepreneurship (BASE), at the University of North Carolina at Chapel Hill's Kenan-Flagler Business School, was launched in January and serves 21 triple-bottom-line startups. Entrepreneurs pay $600 for the one-year program. BASE doesn't provide office space, but companies get advice from a 13-person advisory board as well as a network of lawyers, accountants, and other professionals. MBA students work as consultants. Regular lunches cover such subjects as marketing and financing.

For Beehive's Shander, the Founder Institute in San Francisco was ideal. The institute, which calls itself an equity exchange program, provides online access to mentors and workshops for those who can't come to its offices. "Why should we expect people to drop everything and pursue an idea when it's not fully fleshed out?" asks founder Adeo Ressi.

The institute takes 3.5% of each company in the form of warrants, which become part of a bonus pool the incubator shares with mentors and fellow startups to encourage collaboration. Shander enrolled when the institute opened in June and is planning a soft launch of his company, Buzub, this month. "It has made me a better businessperson all around," he says. | BW |

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Ask Your Doctor If This Ad Is Right for You

The drug industry is spending billions on TV ads, but they may be scaring consumers away



By Arlene Weintraub

Does it seem like you hear the phrase "ask your doctor" every time you turn on the TV? There's a reason. Drug companies spend about $5 billion a year in the U.S. on ads imploring people to talk to their physicians if they think a pill they've read about or seen on TV might help them. Such ads are so pervasive one might assume viewers are heading to the doctor knowing which drugs they want. But new research based on recordings of conversations in physicians' offices suggests most patients aren't asking for drugs by name. Or they're only asking about scary side effects, which drugmakers have to include in ads, often in stomach-turning detail.

Market researcher Verilogue recorded 12,500 patient-doctor conversations in 2008 and found only 23 requests for specific drugs. And according to the new study, which Verilogue showed to *BusinessWeek* in advance of its Nov. 9 release, the most expensive ad campaigns did not prompt the greatest number of inquiries. Eli Lilly spent $179 million on ads promoting its depression drug Cymbalta in 2008, making it the year's most pricey pharma campaign, according to TNS Media Intelligence. But the most frequently cited drug by patients was Boniva, for osteoporosis, which GlaxoSmithKline and Roche co-marketed. The Boniva campaign, starring actress Sally Field, cost half as much as the Cymbalta blitz.

$4.7 billion

Spending on direct-to-consumer drug advertising in 2008

Data: TNS Media Intelligence

Verilogue's research will be sobering news to many in the pharmaceutical business. Despite the recession, the industry is still spending heavily on direct-to-consumer (DTC) ads—and taking flak for it. DTC spending is down just 7% so far this year, a relatively small drop. Retailers, by contrast, have slashed advertising by 18%; spending on auto ads is down 31%.

Some lawmakers wish drug companies would exercise more restraint. On Oct. 8, Senator Al Franken (D-Minn.) introduced a bill proposing that drugmakers no longer be allowed to deduct marketing expenses from their taxes, as companies generally can. "This legislation will remove these benefits so pharmaceutical companies can focus on developing new drugs, not excessive marketing schemes," Franken's office said in a statement.

The Verilogue study suggests those ad schemes often backfire, anyway. For example, researchers found that the fifth most heavily advertised drug, sanofi-aventis' insomnia remedy Ambien, was often remembered for side effects like hallucinations, sleep-eating, and other problems. "I think it's, uh, Ambien that says you might go out to eat and not remember," said one patient in the study. "I thought, 'great, all I need.'" The campaign cost sanofi $151 million last year, and Ambien sales actually fell by 37%, to $806 million. Sanofi declined to comment.

Verilogue CEO Jeff Kozloff believes pharmaceutical companies aren't doing a thorough job preparing doctors to discuss such worries. He says they should be giving physicians brochures, visual aids, and even anecdotes they can use to help patients weigh the benefits and risks of a drug. "Patients are looking for their concerns to be addressed up front," Kozloff says.

Companies can also adopt another proven strategy: promoting drugs using real patients who also happen to be famous. It worked for Boniva. According to researcher IMS Health, prescriptions for the osteoporosis drug were up 11% last year, and sales of the drug grew 25%, to $675.6 million. Sally Field, who played the Flying Nun on TV, as well as Norma Rae on film, happily tells everyone Boniva halted and reversed her bone loss. "The term you hear across the board in advertising is 'authenticity,'" says Richard "Erik" M. Gordon, assistant professor at the University of Michigan's Ross School of Business. "People want to believe a celebrity isn't just doing this because they were paid a pile of money." |BW|

PAUL HOPPE

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INNOVATION & TECHNOLOGY

Praise the Company, Pocket the Stock

Broadband player KeyOn is getting glowing reviews —from supporters who have been paid in shares

By Ben Steverman

Although the U.S. stock market has soared in recent months, few companies can match the meteoric rise of a small Internet player in Omaha. Since May 1, the stock of KeyOn Communications has climbed to $2.10 from 4¢, an increase of more than 5,000%. No company in the Russell 2000 Small Cap Index came close over that period.

Investors have bid up KeyOn's stock on hopes it will get a slice of the billions the federal government is doling out to expand broadband Internet service in the country. KeyOn has applied for about $150 million in grants and loans, which it says it will use to expand operations and improve financial performance. Today the company provides wireless Net service to 15,000 rural customers in 11 Western and Midwestern states. "We certainly weren't worth [just] 4¢," says Jonathan Snyder, KeyOn's chief executive. "We have a real business with real customers and real product, and a business that can generate real cash flow."

NO GOVERNMENT CASH?

But KeyOn isn't generating cash now, and it's far from clear it will ever be able to deliver on investors' high hopes. The stock's run has been fueled by bullish comments from an analyst who has been paid by the company, a questionable practice that has not always been disclosed to investors. KeyOn is losing money and has issued stock eight times this year to cover its cash needs. And it's quite possible KeyOn will never see a penny of government broadband money, since requests for funds total seven times the money available.

KeyOn went public in 2007 and saw its stock hit $16 before it ran into the buzzsaw of last year's recession. As credit dried up and investors fled risky stocks, KeyOn shares dropped to $2 last May and pennies by yearend.

The company's fortunes began to change in mid-May when it hired John Liviakis, whose Mill Valley (Calif.) firm takes stock in companies in exchange for publicizing their prospects to investors. Liviakis says his goal has been to create a "national presence" for KeyOn, working the phones to his database of brokers and institutions. By the end of May, KeyOn shares hit 72¢.

Snyder insists one analyst who took stock has been "pretty evenhanded"

The stock has kept rising on positive comments from other supporters. Joseph Noel, an analyst with Emerging Growth Research, began issuing bullish reports and interviews about KeyOn in July. In one interview posted online in September, he said: "You're going to see this company awarded a lot of money." What he doesn't tell investors in the interview is that before he began covering KeyOn, it awarded him 75,000 restricted shares. Noel tells *BusinessWeek* that "if people ask, I'm very up front about [my financial stake]."

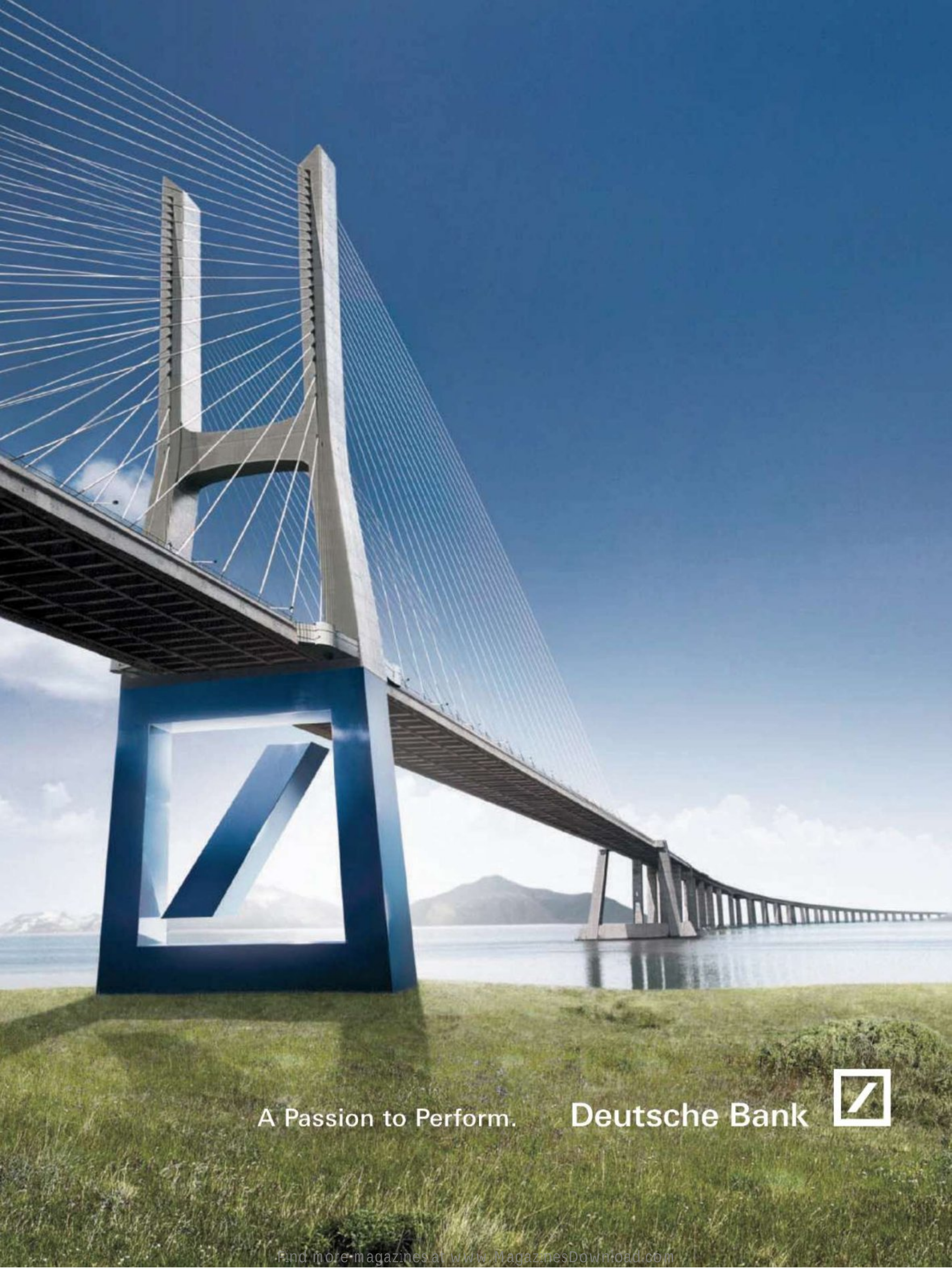
Michael W. Mayhew, chairman of Integrity Research Associates, which advises investors on research issues, says such financial transactions are a red flag. "The paid-for-research industry has a stink to it, of being biased, of maybe even being a scam," he says.

KeyOn CEO Snyder says Noel's analysis of his company has been "pretty evenhanded." He adds: "If [Noel]'s not properly disclosing, I don't think he's doing it maliciously."

It's almost impossible to know if KeyOn will get broadband money. In response to an online version of this story, Snyder argues his chances are good because of KeyOn's experience, technology, and partners. "All applicants are not created equal," he says. Yet experts say the odds of success for any company are long. "Because of the demand and the competition, there are going to be a lot of disappointed folks out there," says James Lightfoot, head of ACRS 2000, an adviser to companies on the application process. |BW|

JARED MCMILLEN

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MONEY REPORT

INDIA: THINK SMALL



Van Eck Global's Market Vectors Small-Cap Brazil Exchange Traded Fund is quite the success story, returning 74% and seeing assets swell to about $500 million since its May launch. Now Van Eck is rolling out an ETF to track India's small companies. On Oct. 23 it filed a preliminary prospectus for the Market Vectors India Small-Cap ETF, which will provide U.S. investors with access to a potentially more lucrative corner of the Indian market. Smaller companies have rallied this year, with the SPDRS S&P ETF of small-cap emerging-market stocks besting a wider basket of emerging-market stocks by some 18 percentage points so far in 2009. The Jakarta Composite Index—India's broad benchmark—is up 76% this year. The filing warns that currency risk and the illiquid nature of the stocks may result in extreme volatility. *–Tara Kalwarski*

SCRAP METAL

A BARGAIN RECYCLING PLAY?

On Oct. 29 the stock of Sims Metal Management plummeted 5.4% despite better-than-expected profits. Last quarter the Australian scrap metal recycler got a boost from rising steel prices, as the value of scrap soared 26%. October, however, was a rough go: Steel prices dropped 21%, and Sims expects the decline to continue as seasonal slowness curtails demand.

The beginning of next year could be a different story, says Jackson Robinson, manager of Winslow Green Growth Fund, which owns the stock. Emerging-market economies should continue their strong growth, and if the U.S. continues to recover, that will boost demand for steel in transportation, infrastructure, and construction projects. "As long as we see some progress in the developed countries, [the stock] can do well," Robinson says.

21%

Decline in steel prices in October

Data: Bloomberg

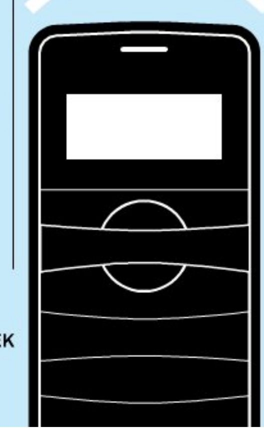
If the U.S. economy slows, Sims' strong balance sheet—net debt is only 10% of total capital—and ability to respond quickly to economic changes by dumping inventory should protect it. Says Robinson: "At 18 or so, it's very attractive." *–Ben Levisohn*

MEDIA

A U.K. BUY

Positive earnings news from Virgin Media on Oct. 29 gave the shares a 7.2% boost, to 15. The British conglomerate reported that average revenue per user reached a record of about $73 in the third quarter. CEO Neil Berkett also said the share of customers who subscribe to all four of the company's services—broadband, TV, telephone, and mobile services—is more than 10%.

A slew of firms, including UBS and JPMorgan Chase, maintained or upped recommendations to buy. Matt Harrigan, a senior analyst at Wunderlich Securities in Denver, raised his price target 37%, to 24, citing the company's progress in attracting higher-end customers. What might put a damper on his rosy outlook? An "uncertain U.K. economy could ultimately hurt demand," says Harrigan. *–T.K.*



MARCO CRISTOFORI/ROBERT HARDING WORLD IMAGERY/CORBIS; ILLUSTRATION BY MARK FOSTER/BW

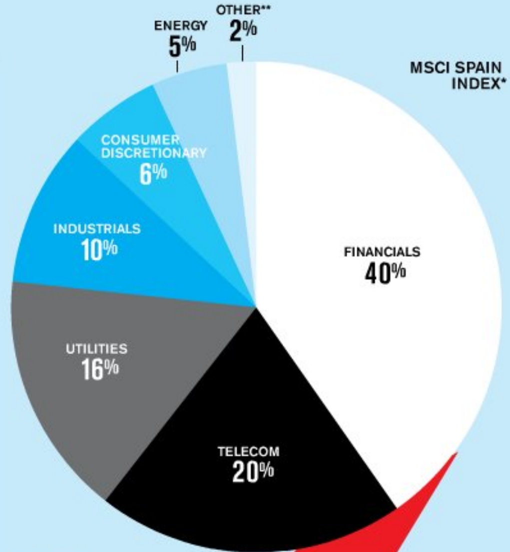
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Spain: Seeking New Worlds to Conquer

(FROM PAGE 074)

By Tara Kalwarski

Spain is expected to experience another year of economic contraction in 2010, but that bleak outlook hasn't put a big damper on the country's stocks. MSCI's index of Spanish companies lost less in 2008 than the MSCI index that tracks the European Monetary Union, and so far this year Spain's 33% gain tops the overall euro zone's 20% (chart below).



*As of Nov. 2
**Includes materials, technology, and health-care sectors

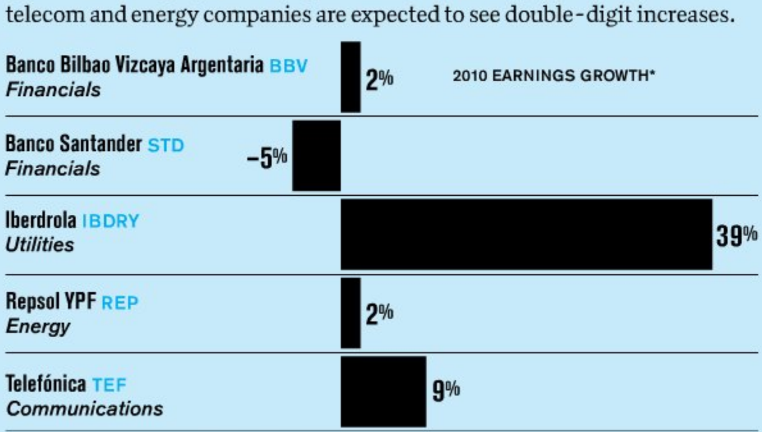


Data: Bloomberg

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THE HOT AND THE NOT

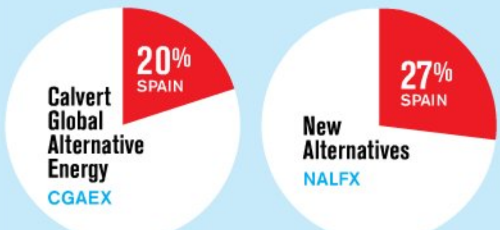
Financial companies in the MSCI Spain Index are projected to experience weak earnings growth in 2010, while telecom and energy companies are expected to see double-digit increases.



Data: Bloomberg *Projected; as of Nov. 2

ENERGY EXPOSURE

Investors can use these two funds to gain exposure to Spanish renewable-energy companies; their top holdings include EDP Renovaveis, Acciona, and Iberdrola Renovables.



Data: Morningstar

CHARTS BY RAY VELLA/BW

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STOCKS

MARKET DIVIDE

By Ben Levisohn

The stock market's surge ended in October. After seven months of gains the Standard & Poor's 500-stock index closed at 1036.18 Oct. 30, down 2% for the month. Investors are left to ponder whether this is a pause or prelude to a deeper dive. In other words: Is the market overvalued or undervalued? As these experts show in their analysis of the market's price-earnings ratio, the answer depends on whether you're looking back or looking ahead.

THE S&P 500: ROOM TO RUN

DAVID BIANCO
Chief U.S. Equity Strategist, Bank of America Merrill Lynch
S&P 500 Fair Value: 1150

Forget the past, says Bianco. Current corporate profits remain beaten down and reflect an economy in crisis. Calculations using "normalized trailing earnings"—an average of past results over a 10-year period—reflect the economy as it was, not as it will be. The market looks forward, and investors should, too. While analyst predictions are imperfect, Bianco argues that consensus earnings estimates give the best sense of where the market believes corporate profits are headed.

Using current earnings expectations of $70 per share for the S&P 500 in 2010 implies the market should peak around 1050. The economy is expected to be sluggish next year, and corporate profits won't recover until 2011, when consensus earnings estimates for the S&P 500 are $80. "But what if 2010 were normal?" asks Bianco. To see what that would look like, he subtracts the 6% real return investors expect of stocks from $80. That suggests earnings would come in around $76, and that the S&P 500 trades at a price-earnings ratio of 13.9. Bianco thinks that's too low. The market should trade with a p-e of about 16, based on expectations of a 6% real return. He predicts the S&P will finish the year at 1100 and hit 1200 by mid-2010. "The economy and earnings are supportive of the market," he says. "I don't see a big pullback."



THE S&P 500: HITTING A WALL



DAVID ROSENBERG
Chief Economist & Strategist, Gluskin Sheff
S&P 500 Fair Value: 875

True, looking over your shoulder is not a perfect way to value the market, says Rosenberg of wealth-management firm Gluskin Sheff. During a recession, companies struggle to turn a profit and price-to-earnings ratios tend to balloon. But at least those figures are real. Earnings expectations are just a best guess and usually wrong. And right now, estimates are all over the place, making them more unreliable than usual.

So despite the ailing economy, Rosenberg uses current earnings to compute the market's p-e. That leads him to believe the market is overvalued, since it puts the market's p-e at 27.6 times operating earnings. That's way above where it usually is, in the mid-teens. And the p-e has been higher only 2% of the time since 1960. It is also inflated relative to where it's been at the end of other recessions. In 1991, the p-e on the S&P 500 was 17.2; in 1961 it was 20.5.

Rosenberg believes that the stock market is already pricing in an economy running at full strength, with gross domestic product growing 3% to 4%, rather than one with profits typical of the middle of a recovery and GDP growth at 1% to 2%. Analysts predict S&P 500 earnings of $80 in 2011, twice the level of profits when the S&P bottomed in March. Historically it has taken four to five years following a recession for that to happen. "Either the fundamentals have to catch up with price or price has to catch up with the fundamentals," says Rosenberg. "If we correct to 900, I would be rubbing my hands and licking my lips." | BW |

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HEALTH CARE

ELDER CARE BY REMOTE

By Arlene Weintraub

For three months early this year, 63-year-old Ronald Lang was one of the most plugged-in patients in America. Lang, who suffers from congestive heart failure and multiple sclerosis, was pilot-testing the Intel Health Guide, a device that lets doctors monitor his health remotely. Each day after he woke up, he'd step on a scale and strap on a blood pressure cuff that was attached to the Health Guide. The device collected his vital signs and zapped them to his doctor's office. From there, Nurse Marie DiCola scoured the data, and if she noticed anything amiss, she dialed Lang and chatted with him over Health Guide's videophone.

Health Guide is at the leading edge of a new technology trend called "aging in place," designed to help seniors stay longer where they're most comfortable—at home—rather than having to move into nursing or assisted-living facilities. Aging-in-place equipment is installed in a person's home, monitors symptoms on the spot, and sends reports to doctors or family members in real time.

As 77 million baby boomers race toward their golden years, the world's leading tech innovators are unveiling a range of futuristic gizmos. There are beds that can monitor patients' vital signs as they sleep and stoves that can turn themselves off when owners forget. Besides Intel, the aging-in-place market has attracted companies such as General Electric, Philips Electronics, Honeywell, Bosch, and dozens of tech startups. The companies say these products, just now being deployed by a handful of health plans and home-care agencies, can drastically cut the rate of medical complications that force seniors into hospitals and other intensive-care facilities.

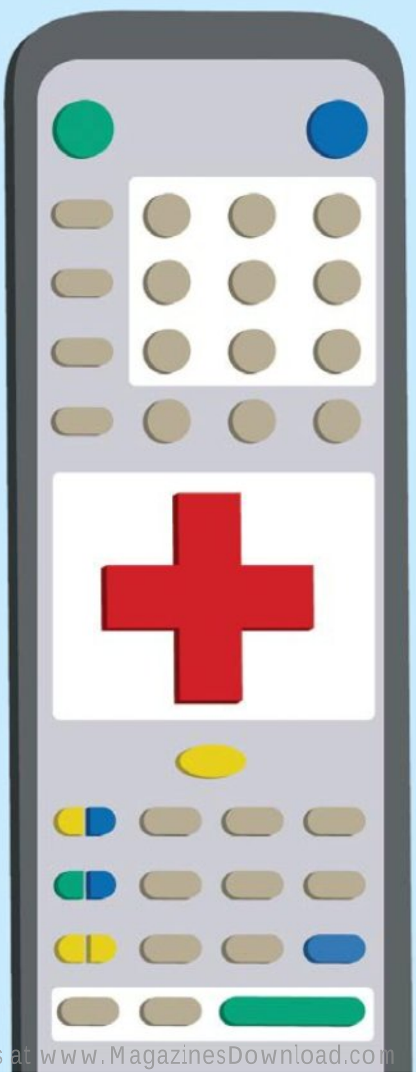
Health Guide epitomizes the kind of in-home gear that can reduce the hassle factor for patients and clinicians, especially those dealing with chronic but easy-to-monitor diseases. Heart failure patients, for example, must measure their weight and blood pressure frequently because changes in either metric can signal the type of trouble that requires emergency intervention. But distinguishing between a minor setback and a serious situation depends on being able to figure out how the patient is feeling.

80%

Percentage of baby boomers who expect to stay at home as they age

Data: AARP

In the program Lang was a part of, Nurse DiCola was able to assess symptoms both by talking to patients and examining them visually. She downloaded real-time data for as many as 25 patients every day and spoke to many using Health Guide's videophone. "I could make decisions about treatment," she says. "If they needed to see the doctor, I got them in to see a cardiologist right away." For Lang, desktop access to DiCola was comforting. "I used to have to get dressed, go to the doctor's office, wait, and pay my $10—just for them to take my blood pressure," Lang says. "Then the doctor would say: 'Everything is fine. Take your medicine.'"



TAMARA SHOPSIN

Executives at Intel envision a suite of products that can give any house the characteristics of an assisted-living facility, but without the sterile environment many seniors despise. A survey taken late last year by AARP revealed that nearly 80% of baby boomers expect to stay in their homes as they age.

Intel has enlisted a big ally to help position itself in this market. In April, Intel and General Electric announced they would spend $250 million over five years

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TRACKING THE TRENDS

ageinplacetech.com	A tech industry veteran and elder-care expert founded this site, which features articles, research reports, industry analysis, and other content related to aging-in-place technologies.
agingtech.org	The Web site of the Center for Aging Services Technology (CAST) has a number of reports discussing aging-in-place technology. It also has a video of a real patient who has been outfitted with some of the technologies.
ageinplace.org	The National Aging in Place Council has launched a site full of advice for seniors who want to stay at home. A section called "Top 10 Product Ideas" describes helpful gadgets such as amplified phones and wireless keyboards.

to co-develop products that will help seniors manage chronic conditions from home. As part of the deal, GE will sell the Intel Health Guide. The partnership will give Intel access to monitoring technology, which ultimately could enhance Health Guide's capabilities. GE already has a product, QuietCare, which uses sensors stationed throughout the home to keep an eye on seniors as they go about their day-to-day lives. GE is marketing the product through home health-care companies and to assisted-living facilities. For an individual who wants the system at home, it's not cheap—the cost would be about $70 to $110 per month, depending on the size of the unit and the length of the monitoring agreement.

Amsterdam-based Royal Philips Electronics is also focusing on the aging-in-place market. Since 2006 it has spent $6 billion snapping up home health-care companies, including Lifeline, a maker of personal emergency alert systems that cost subscribers from $35 to $75 per month. Philips also purchased breathing device maker Respironics, as well as Raytel Cardiac Services, a provider of remote cardiac monitoring services. And recently Philips developed the smartBed, which contains tiny, high-tech electronic sensors that can measure patients' vital signs, movement, and breathing as they sleep. (The product is part of a research project and not commercially available.)

As helpful as aging-in-place technology may be, there is one big question yet to be answered: Who is going to pay to put the systems into seniors' homes? "Right now this is a niche market made up of affluent people who want to monitor their parents," says Scott Lundstrom, vice-president for research at IDC Health Insights. "The technology is going nowhere without a reimbursement model that supports it."

Intel and others are trying to convince public and private insurers that it is an investment worth making. During a road show to launch Health Guide, Intel referred to a study published by the Veterans Administration late last year. It found that remote patient monitoring decreased hospital visits significantly—for instance, 20% for diabetes patients and 56% for patients with depression. The technology cost $1,600 per patient per year on average, it reported, as opposed to $77,745 for nursing home care. Intel says it's currently talking with health-care organizations that may provide the full package of service and support directly to consumers. It is also evaluating monthly service programs.

Intel has pilot-tested Health Guide with Aetna and other insurance companies. Lang, who lives in Cypress, Calif., was part of a test conducted by SCAN Health, a nonprofit health plan in California and Arizona. "It became obvious, as we looked at the growth of the aging population and the number of caregivers we had, that relying on an entirely people-based model would be untenable," says Hank Osowski, senior vice-president for corporate development at SCAN. Osowski isn't ready to commit to any specific system, but says remote monitoring will be part of SCAN's model. "We're willing to fund these tools," he says, "because at the end of the day it will result in better [patient] outcomes." BW

—With Kerry Capell in London

BUSINESSWEEK.COM
For more information about technologies to enable aging in place, visit businessweek.com/go/09/aging

BRAIN WORKOUTS

Can games prevent cognitive decline? Several companies think they might. Posit Science sells the Brain Fitness Program for PCs for $395, and there's Brain Age for Nintendo's DS handheld system (about $20 for the game, $130 for the device). The newest entrant is Dakim BrainFitness, which sells [m]Power Cognitive Fitness System. It's sold as a computer with 120 different games, each with five skill levels. In one, players watch scenes from old movies, then recall such details as characters' names and lines. Another, The Violin, uses recordings of famous classical musicians to engage players in a tutorial on the instrument. The unit, which sells well to nursing homes, is costly, at $2,295, plus $19.99 per month for updates. Dakim is working on next-generation systems that can track a player's cognitive function over time and report changes to family members or doctors. That could help detect small strokes or early signs of dementia.

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PUERTO RICO
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Embracing innovation to focus on a knowledge based economy for the future.

With a strategic location in the heart of the Caribbean and a modern infrastructure, Puerto Rico has a growing reputation as a leading investment destination and innovation platform.

With a young and ambitious population of four million, the island nation's key sectors include the manufacturing of pharmaceutical and medical devices, food processing, and tourism.

As a U.S. territory, Puerto Rican products are not subject to U.S. duties or quotas. Heavy investment in a new marine port and upgrades at its main airport will transform the country into a commercial hub.

A leading exporter of talent, both the private and public sectors are working hard to secure a bright future for the country through a focus on better knowledge, privatization, and improved efficiencies.



> "Our educational system was developed to produce graduates for multinational enterprises."
>
> **Marilina Lucca Wayland, Chancellor, Inter American University of Puerto Rico, Metropolitan Campus**

As such the government is transforming the industrial based economy through the dual approach of a highly educated workforce and a focus on scientific and technology research and development (R&D).

"In terms of a knowledge based economy, we are not only talking the talk, but walking the walk by investing heavily in education and education related facilities," says Secretary of State, Kenneth McClintock. "Puerto Rico boasts world class manufacturing facilities and a very loyal workforce. We are looking for an integrated, vertical operation where businesses can do R&D relatively inexpensively because of low labor costs and excellent scientific knowledge."



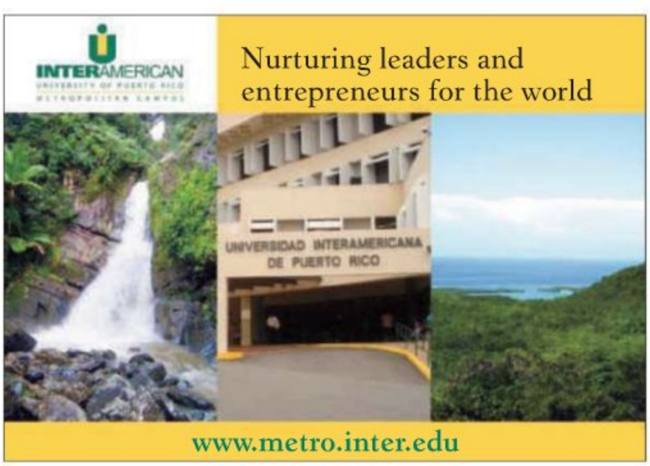
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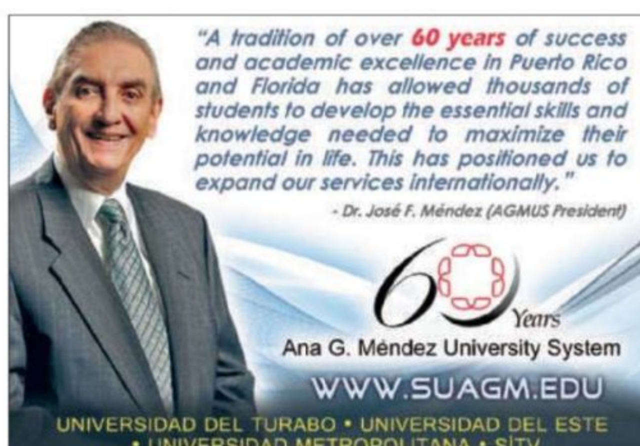
That vision is shared by Carlos Chardon, Secretary of Education, who is overseeing major changes in the nation's education system as it looks to evolve and innovate. "We are investing more than U.S.$150 million next year in retraining which will really shake the system," he states. "Our focus for the next five years is on science, math, English, and Spanish, which are the skills needed to compete in today's globalized economy."

Helping the island achieve this goal is the Inter American University of P.R., Metropolitan Campus. Part of the Inter American University System, the university promotes a more flexible and technological way of learning. The campus recently teamed up with Microsoft to establish a hi-tech innovation center. "Our educational system was developed to produce graduates for multinational enterprises," says chancellor Marilina Lucca Wayland.

A leading exponent of science and technology, Inter American University of P.R., Bayamón Campus offers specialist courses in biology, biotechnology, environmental sciences, and aviation, among others. Headed by chancellor Juan Martínez, the university is looking for foreign investors to help it to create more world class facilities, particularly in research fields.







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Puerto del Rey Marina. www.puertodelrey.com

Meanwhile, with 40,000 students, the Ana G. Méndez University System is a leader in bringing academia, government, and private industry together. The university boasts global alliances with countries such as Argentina, Costa Rica, and Panama. "We see ourselves as a promoter of economic development. Universities that want to be successful have to become international in that respect," states president, José Méndez.

A relatively new but unique institution, Atlantic College pioneers the development of digital animation and graphic design. "If you want to be part of a creative and successful institution and be the best, you have to study here," say president Teresa de Dios Unanue and vice-president Heri Martínez de Dios. In 2007, the college won a Suncoast Regional Emmy Award for Best Technical Achievement.

Banking and financial services are also driving Puerto Rico's future success and prosperity. Leading mortgage lender R-G Premier Bank of P.R. is committed to environmentally friendly policies. "We have taken a proactive role in promoting environmental responsibility," says the bank's president, José Díaz.

With a welcoming climate complemented by beautiful beaches lapped by the warm Caribbean Sea, it's easy to see why tourists flock to Puerto Rico in ever increasing numbers. Puerto del Rey Marina is the Caribbean's largest marina and a magnet for international visitors. "The marina is ideally situated for nautical tourism between the islands of Vieques and Culebra, the U.S. and British Virgin Islands, and Puerto Rico's east coast," says company president, Daniel Shelley.



BARBADOS

Wealth of a nation

The Central Bank of Barbados keeps a close watch on the financial services sector

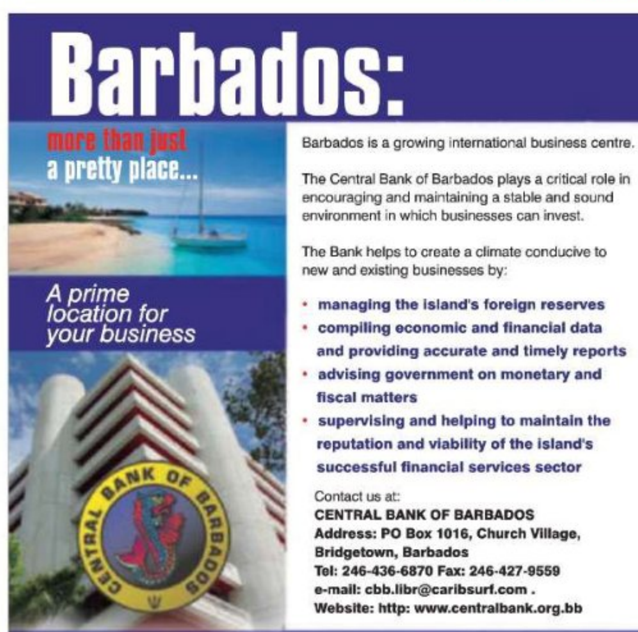
With a thriving economy built on its long established tourism industry, Barbados is the Caribbean's leading foreign direct investment destination as it offers international investors a safe haven from the global economic storm. A leading financial offshore center, Barbados is the region's financial services capital and acts as a powerful magnet for global companies and investors seeking a secure climate for their investments.

The highly respected Central Bank of Barbados is the guardian of the island's economy and provides a safe and stable financial environment for citizens, visitors, and foreign investors. The bank has a powerful array of tools with which it regulates the industry through licenses, reviews, and on-site inspections. Famous for its low-tax environment, the financial services industry helps drive growth in the economy, with the Central Bank of Barbados also responsible for monetary policy and inflation controls. In addition, the central bank liaises closely with the government, financial services officials, and overseas regulators and foreign central banks.

"The financial services sector is quite vibrant here," says Central Bank of Barbados Governor, Marion Williams. "Barbados is a low-tax jurisdiction that operates to international guidelines. Most of the domestic financial services providers cater to the regional market.

"While we have other international financial entities, they cater mainly to clients who are wealth providers or overseas based owners of substantial wealth."

by Business Focus www.businessfocus.org.uk



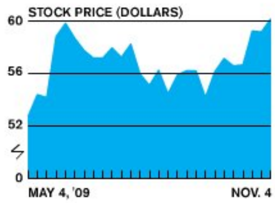
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McDONALD'S: SET TO SIZZLE?

Incredible but true: McDonald's missed this year's robust stock market rally. While the Dow is up 11%, S&P 15%, and Nasdaq 30%, shares of the world's largest fast-food restaurant chain are off 3%. But some savvy pros regard the lag as an opportunity. "McDonald's [MCD] is the only new name we added this year to our portfolio," says Edwin Walczak, U.S. portfolio chief at Swiss bank Vontobel. From a 52-week high of 64 on Jan. 6, the stock has slipped to 60.34. Part of investor concern is McDonald's lower forecast for store openings, mostly in China, Japan, and Eastern Europe. At this depressed price, says Walczak, "the stock is a bargain as McDonald's continues to innovate in its core menu and business structure." He figures that with estimated earnings of $4 a share in 2009 and $4.50-$5 in 2010, it is worth 75. Using its "prodigious excess cash flow," he notes, McDonald's has been buying back its shares.

McDONALD'S IS LATE TO THE RALLY



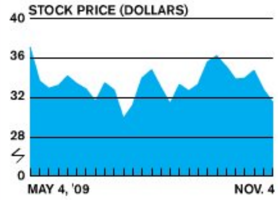
Data: Bloomberg

Sara Senatore of investment firm Sanford C. Bernstein, who rates McDonald's outperform, says the modest decline in store openings simply reflects a temporary weakness in demand. She's encouraged by McDonald's decision to expand in its growth markets, including Australia, France, and Russia. "We see ample room for unit expansion in most of McDonald's markets."

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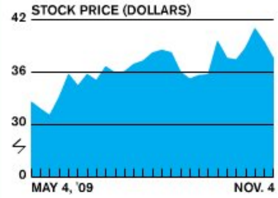
Data: Bloomberg

How Expeditors Moves the Freight

Expeditors International of Washington (EXPD) sounds like a lobbying group. Far from it: The Seattle outfit is a global provider of air and ocean freight-forwarding services to importers, exporters, and distributors of such goods as electronic gear and machine parts. "Expeditors charges less than FedEx or UPS, so the earnings and cash flow remain strong despite the weak economy," says Scott Armiger of Christiana Bank & Trust, which owns shares. Expeditors doesn't own planes, trucks, or ships, so it is cost-efficient and unburdened by huge capital expense. It buys space in bulk from airlines and ocean freight ships and then resells it to clients.

Jim Corridore of Standard & Poor's sees the stock, now at 31.49, at 43 in a year. Expeditors' diversified revenue base, geographical reach, and methods of shipping allow it to outperform its peers, says Corridore.

OPEN TEXT IS A TEMPTING TARGET



Data: Bloomberg

Open Text: Maybe Open Season

Open Text (OTEX) is the largest independent provider of "enterprise content management" software, which lets users collaborate, share, store, and retrieve info on the Web. The company's allure is that it boasts some major tech partners, including SAP, Microsoft, and Oracle.

Open Text stock, now at 37.41, is down from its 52-week high of 41 on Oct. 19, but many fans believe it will reach 45 in a year. "It is one of our best stock investment ideas and a top holding, which we expect will continue to gain market share," says Richard Parower of investment firm Seligman Investments. He predicts Open Text will be a likely takeover target for one of its partners.

Steven Li of investment firm Raymond James rates the stock outperform and also has a 12-month target of 45. He sees Open Text earning $2.91 a share in fiscal 2010, ending June 30, and $3.34 in 2011, vs. 2009's $2.49. | BW |

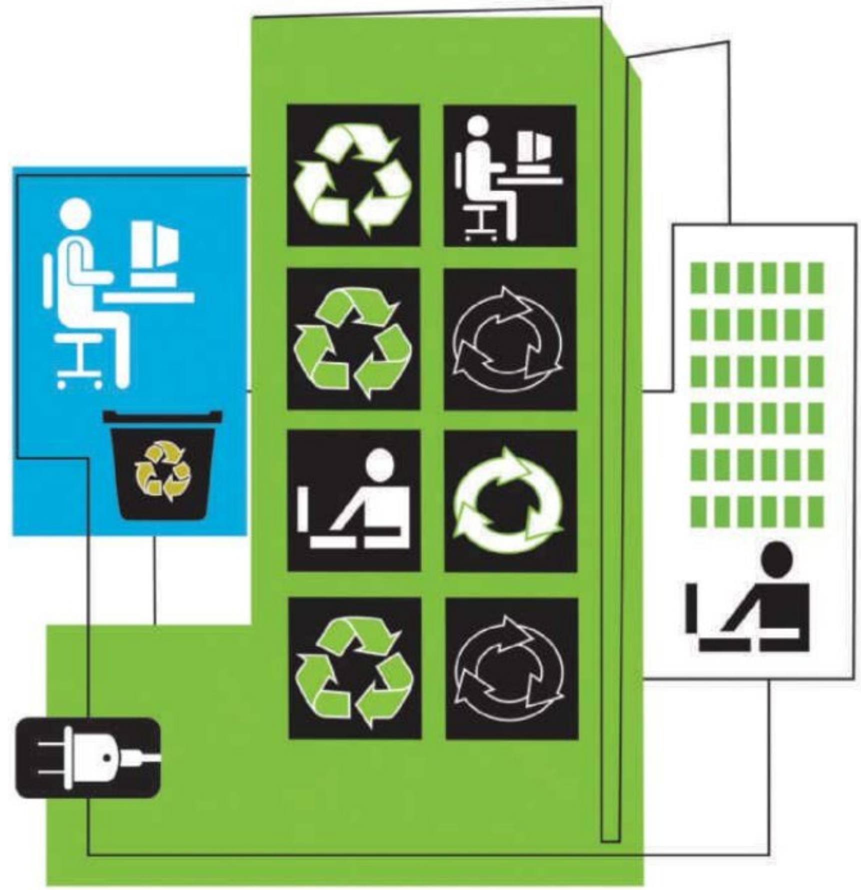
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More efficient datacenters cost less to run and reduce our impact on the environment



Let's say that just as you're about to click to confirm an order at an online emporium like Amazon.com or eBay, the power goes out. No big deal, just restart the PC when the lights go back on and redo the order. Not so for Amazon, eBay and other Web storefronts of the world because when their Internet servers go down, they're out of business.

For many online sellers, downtime means millions of dollars a minute in lost sales, which is why their servers are powered by uninterruptible power supplies (UPS) that can tolerate being without power for short periods. "Having a UPS is the difference between surviving a power failure and a datacenter going south," explains Pedro Robredo, Three-Phase UPS Product Line Manager at Eaton Corporation's Power Quality Division. "They power the Internet." The Cleveland company is a global industrial manufacturer that specializes in datacenter equipment.

A UPS runs day and night, ready to step in with battery power to keep servers humming during a black out, but the typical UPS runs at 80- to 95-percent efficiency. That might sound pretty good, but it means that watts are wasted every minute.

"A small amount of lost efficiency adds up quickly to a lot of money and carbon emissions," explains Mark Monroe, the Director of Sustainable Computing at Santa Clara, California-based Sun Microsystems and a board member of The Green Grid. An international non-profit organization, The Green Grid creates ways to measure how much power business computing uses and improve its efficiency.

A large datacenter can waste nearly $28,000 a year in electricity, according to Eaton's Robredo. More to the point, that's an extra 100 tons of carbon dioxide that contributes to global warming released annually into the atmosphere from power-plants.

A good place to start is Eaton's Energy Saver System UPS family, which operates at 99 percent efficiency, claims Robredo. "They run at peak efficiency and can pay for themselves in three years with lower power bills."

Taken together, datacenters use 1.5 percent of America's electrical supply, or about as much as the entire state of Florida. With some larger datacenters spending upwards of a million dollars a year on electricity alone, more efficient operations means lower power bills, less carbon spewed into the air and a strategic business advantage.

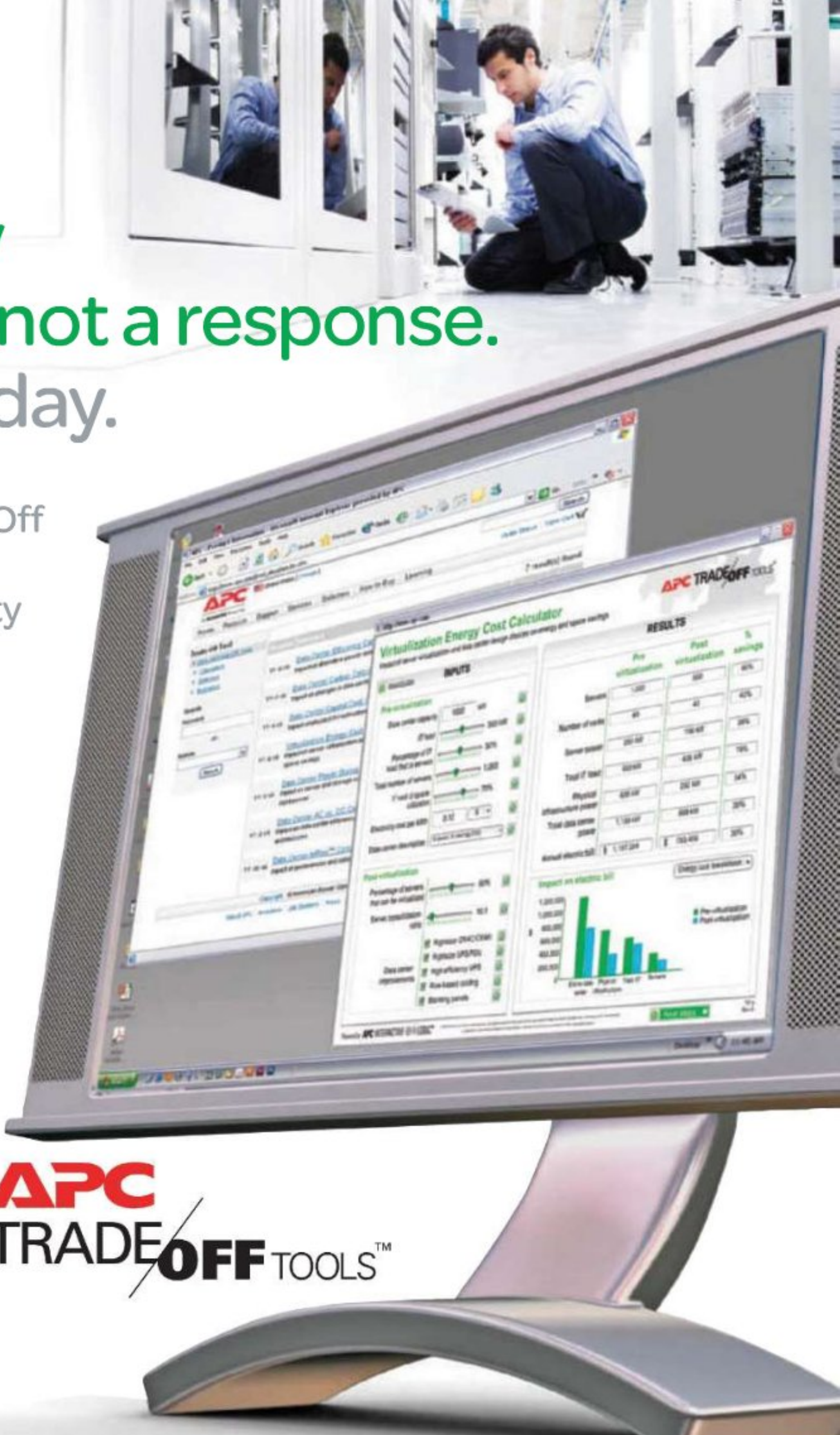
"Energy usage is absolutely a controllable cost, and efficiency gains in the datacenter will help drive global energy savings," says Jim Simonelli, Chief Technical Officer at APC by Schneider Electric. "What's good for datacenters is good for the planet. We need to address global warming and power use before it's too late." With the recent addition of APC, Schneider Electric makes all the electrical equipment

> **"What's good for datacenters is good for the planet"**
> **JIM SIMONELLI**

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needed to build a datacenter, except the servers themselves.

Look inside the typical datacenter and you'll see endless rows of racks of computers with cool air blowing all around to keep them from overheating. "Cooling is an area that's ripe for cutting waste," adds APC's Simonelli. "A thoughtfully designed new datacenter can cut power use by 40 to 50 percent without compromising reliability."

APC's Capacity Manager software models a datacenter's cooling and power before a single computer is installed. The program points out hot spots, helps optimize air conditioning placement and shows opportunities to raise efficiency. "It's quicker, cheaper and easier to do 'what if' scenarios on a computer screen before anything is built or before anything is added or changed for an existing data center," he says. "The application truly serves both important needs."

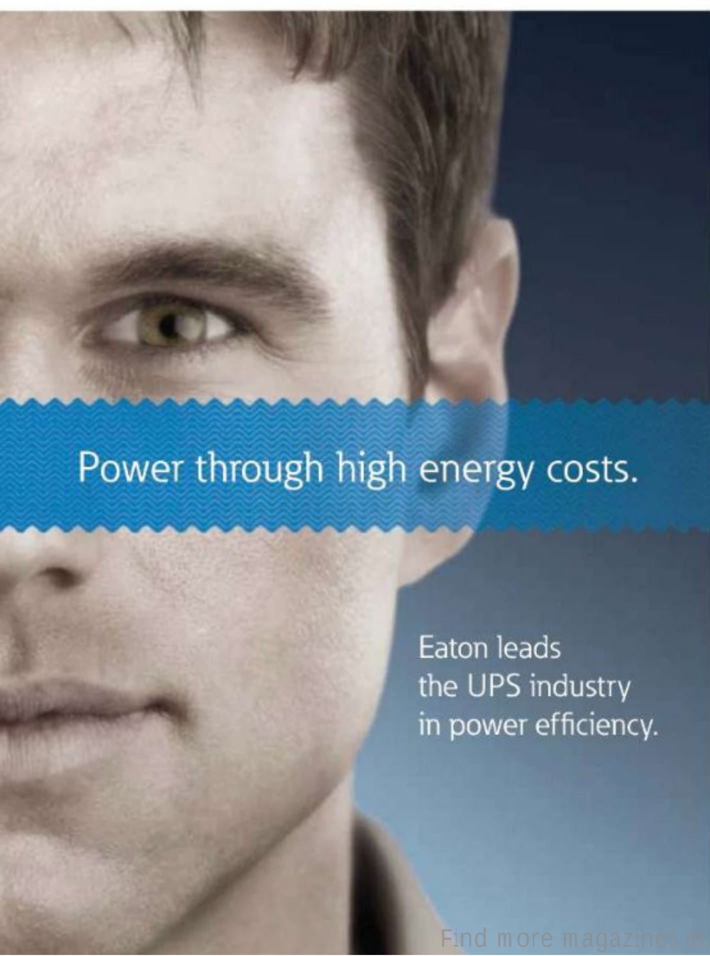
"This is a tremendous opportunity for businesses"

JOHN TUCCILLO

What if we applied everything we know about making datacenters more efficient to renovate an existing facility? This is exactly what The Green Grid and the EPA did when they teamed up to refurbish the agency's One Potomac Yard (OPY) datacenter in Northern Virginia. A mid-sized datacenter, OPY was redesigned for peak efficiency after an intense evaluation by The Green Grid.

The effort paid off with an estimated 20 percent reduction in power use, or a savings of about $15,000 a year. It also means that 55 tons a year of greenhouse gasses won't be pumped into the atmosphere, based on OpenEco's calculator (www.openeco.org). "This is a tremendous opportunity for businesses," explains John Tuccillo, The Green Grid's Chairman of the Board and Vice President of Industry and Government Alliances at APC.

If each of the 75,000 mid-sized datacenters in the U.S. applied what the EPA and The Green Grid learned, we could potentially cut our power bill by $1.1 billion and keep hundreds of thousands of tons of carbon out of the atmosphere. Says Tuccillo, "It's a win on all aspects: lower costs and less greenhouse gasses."



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099 Tech & You: The Android
102 Outside Shot by Pete Peterson

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The Geekdom Of Google

Ken Auletta probes the hard-driving personality of the search giant, where the tech mindset is all-pervasive



VICTOR JUHASZ

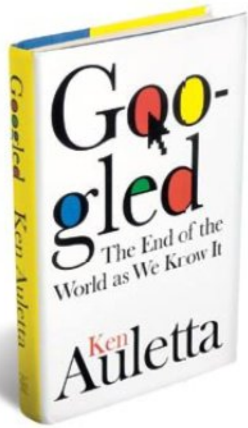
In just the past four years, Google has been profiled in no fewer than six books, from John Battelle's seminal 2005 *The Search* to Jeff Jarvis' *What Would Google Do?* earlier this year to former *BusinessWeek* correspondent Richard L. Brandt's *Inside Larry & Sergey's Brain* in late September. Thanks to Ken Auletta's high profile as media columnist for *The New Yorker* and as the author of eight previous books, his *Googled: The End of the World as We Know It* is among the most anticipated. And for the most part, Auletta delivers.

Googled provides the most deeply reported look yet at what is perhaps the world's most closely watched company. It chronicles how Google has grown into an advertising powerhouse whose revenues now match those of the five broadcast networks combined—most of this coming from those little four-line text ads that appear next to search results. The book comes at a pivotal time for Google. Despite a recent earnings upswing, it faces an increasing number of challenges. It still has not managed to make much money on its many attempts to move beyond search ads. Moreover, resistance to its widening influence is growing from government regulators and its own customers.

With unprecedented access to the

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secretive outfit, Auletta interviewed 150 current and former Google employees along with 150 outsiders. The effort shows in the many entertaining details and anecdotes about Google co-founders Sergey Brin and Larry Page, the acutely engineering-focused culture they created, and their growing conflicts with the rest of the media world they're helping to disrupt. One example: Auletta describes how Page couldn't stop staring at his handheld device during a meeting between the founders and mogul Barry Diller. Diller told him to choose between it and their conversation. "I'll do this," Page replied, not raising his eyes. Diller's conclusion: "More than most people, they were wildly self-possessed."



PROFESSED VIRTUE

That meeting captures an essential truth about Google, one that's a central theme of the book: The company is the most concentrated gathering of left-brain types on the planet. Auletta understands that this engineering mindset is both the company's greatest strength and its Achilles' heel.

On the positive side, the co-founders' focus on providing the best possible search technology allowed them to zoom past rivals such as Yahoo! and AOL, both of which alienated users with their sometimes annoying and ineffective ads. Google uses its mysterious mathematical formulas to give higher play on search results pages to ads that get lots of clicks. It even stops running ads on which nobody clicks, although that means less revenue in the short term. Google's tech mastery means that it now utterly dominates search advertising, with more than 75% of the market.

Google's geeks also question everything, most of all conventional corporate thinking. In what is as much a pointed attempt to lessen management control as it is an employee perk, Google urges engineers to spend 20% of their time on personal projects. The co-founders view their company as being as much a social force as an economic one. In their initial public offering prospectus, the duo said eight times that Google wants to make the world a better place.

Googled: The End of the World as We Know It **by Ken Auletta; Penguin Press; 384pp.; $27.95**

But the company's professed virtue can turn too easily to hubris, Auletta notes. Time after time, Google's executives have been surprised by opposition to their actions. The most conspicuous miscue came last year when Google proposed a search ad deal with Yahoo to keep the latter out of Microsoft's clutches. Google seemed shockingly blind to the likelihood that many outsiders—including the Justice Dept., which threatened an antitrust lawsuit before Google backed down—could question the dominant industry leader's motives.

Readers might feel they've already heard much of what's here, and Auletta sheds little new light on Google's impact. The book also occasionally overplays the company's enthusiasm for strictly data-driven decisions. Google's engineers, Auletta writes, "naively believe that most mysteries, including the mysteries of human behavior, are unlocked with data." Yet so far, that belief seems more savvy than naive, and in any case it's not nearly as absolute as Auletta implies; Google uses thousands of human "raters" to help perfect its search results, for instance.

At the same time, Auletta takes Old Media to task for using Google as a "convenient piñata" for their frustrations about the power the Net gives people over their media consumption. Media companies would be better off embracing change, he contends. "If Google is destroying or weakening old business models, it is because the Internet inevitably destroys old ways of doing things," he writes. "It is a wave-generating company that other media companies ride, crash into, or are submerged by." What no one, including Auletta, can yet answer is how long Google can stay atop the waves it is creating. | BW |

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Google Books: Searching for Agreement

Since 2004, Google has scanned some 7 million volumes for its Google Books project—and been sued by authors and writers over alleged copyright violations. A class action filed by publishers and the Authors Guild ended in a settlement that is still being reviewed by the courts. In an Oct. 4 essay for *The New York Times Book Review*, professor Lewis Hyde, a fellow at Harvard University's Berkman Center for Internet & Society, challenges a key provision of the settlement that involves works under copyright whose owners cannot be located.

To read the essay go to **http://bx.businessweek.com/google/reference/**

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A Big Leap for Android and Motorola

Google's Android 2.0 is much improved, and Motorola's Droid handset is a contender

Android, the heralded smartphone operating system Google unveiled 14 months ago, got off to a slow start because the early handsets were mediocre, and most carriers kept their distance. Now two events may give Android a boost: a new version of the software and Verizon Wireless' launch of the Motorola Droid, which runs on it.

The Droid, available on Nov. 6 for $199 after rebate with a two-year contract, is the first phone to use the much improved Android 2.0. The phone itself is the best product in years to come from Moto. And the new software includes mail, contact, and calendar features that go way beyond those available in the earlier versions of Android. Instead of being forced to rely on Google's Gmail service, for example, you can now combine data from various mail accounts into unified displays. And there's built-in sync of e-mail, contacts, and calendar from corporate Exchange servers—though your company's technology police may not tolerate the fact that data stored on the Droid cannot be encrypted.



The most striking software offering is Google Maps Navigation, which provides real-time, turn-by-turn navigation at no charge. Ironically, a quirky user interface makes it awkward to locate this service in a sea of Google Maps features. But you can circumvent this by using Google Voice Search and saying "navigate to...." If the software understands your destination—not always a sure thing—you are on your way. The driving directions include the spoken name of the next street you should turn on, a feature missing from some phone-based navigation programs. I found the instructions timely and accurate. With the program likely to get even better over time, Google is suddenly a huge force in the navigation industry.

The Droid's list of preloaded software is otherwise bare-bones; for example, there's no built-in video player other than a YouTube app. On the other hand, Droid is happily free of the not-very-good proprietary apps, such as the Vcast subscription video service, that Verizon likes to put on its phones. And if you are feeling app-deprived, just visit the Android Market. It's not the iTunes App Store, but it comes a lot closer than anything else. One slightly annoying oddity: Paid apps are priced in a confusing mixture of U.S. dollars and British pounds. And while music purchases are available from Amazon.com, there are no iTunes-like movie or TV show downloads.

The real-time, turn-by-turn directions you get on the Droid suddenly make Google a huge force in the navigation field

The Droid hardware is impressive. The handset is about the same length and width as the iPhone, but a couple of millimeters thicker and an ounce heavier. That extra thickness allows for both a removable battery and a slide-out keyboard. The 3.7-inch touchscreen is bright, sharp, and responsive. Battery life seems decent—good enough to get you through a long day—but you have to be careful about leaving power-sucking applications such as navigation running in the background. (Once an app is started, you have to make an effort to shut it down.)

The Droid keyboard is just O.K. The key tops are flat and tightly spaced—not a good combination for accurate typing. And the five-way navigation control seems superfluous on a touchscreen device. Also, because the keyboard is clumsily offset more than an inch to the left of center, some keys on the right are hard to reach. The onscreen keyboards, both horizontal and vertical, are acceptable but not as good as those on the iPhone or BlackBerry Storm2.

The Droid's touchscreen is bright and sharp, but the keyboard is just adequate

There will be lots of silly talk about the Droid as an "iPhone killer." The iPhone is too good and has too much momentum for anything to derail it. But for the first time there's a handset that can compete straight up. Android seems to have passed right through its awkward adolescence, and more improvements are sure to follow. | BW |

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COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A Acciona 84
ACRS 2000 80
Advanced Technology Investment 6
Aetna (AET) 88
AIG (AIG) 15, 72
Airbus 34
Amazon (AMZN) 27, 40, 100
AMD (AMD) 6
American Express (AXP) 72
AOL (TWX) 97
Apollo Global (AINV) 36
Arby's 58
Arizona Grand Resort 42
Arvco Financial 36
Ashbury Village 42
Avon (AVP) 72
B Bancomer 74
Banco Real 74
Banco Santander (STD) 74, 84
Bank of America (BAC) 42, 72
BBDO 40
BBVA (BBV) 74, 84
Beehive Media 76
Berkshire Hathaway (BRK) 6
Blackstone Group (BX) 102
Bloomberg 6
BlueGreen 42
BMW 38
Boeing (BA) 34
Bosch 88
Boston Market 58
Boston Scientific (BSX) 48
BP (BP) 32
Burger King (BKC) 58
Burlington Northern (BNI) 6
C Calvert Global (CGAEX) 84
Carena 70
Cepia 27
China Citic Bank 74
China Unicom 74
Christiana Bank 93
Chrysler 38
CIT (CIT) 6
Citigroup (C) 72
CNBC 15
CNPC 32
ConocoPhillips (COP) 32
Costco (COST) 70
Credit Suisse (CS) 42
Cross Harbor Capital 42
Crossroads Mall 42
C.V. Starr 15
D Dakim BrainFitness 88
Dell (DELL) 6
Deutsche Bank 42
Domino's Pizza (DPZ) 58
Doostang 48
Drugstore.com (DSCM) 70
E Eastman Kodak (EK) 102
eBay (EBAY) 27
Edmunds.com 38
EDP Renovaveis 84
efdex 72
Emerging Growth Research 80
Eni (E) 32
Expeditors (EXPD) 93
Experian 48
ExxonMobil (XOM) 32
F FedEx (FDX) 73, 93
Ford (F) 6, 38
G Galleon Group 6
Gamesa 74
GE (GE) 88
General Growth 42
George Comfort 42
GlaxoSmithKline (GSK) 78
GlobalFoundries 6
Gluskin Sheff 87
GM 6, 38
Goldman Sachs (GS) 15, 42
Google (GOOG) 97, 100
Grossman Co. Properties 42
Guaranty Bank 74
GVT 74
H HanseNet 74
Hartford Financial (HIG) 72
Hartman Group 58
Hewlett-Packard (HPQ) 6
Hill-Rom (HRC) 36
Hines 42
Honda (HMC) 38
Honeywell (HON) 88
Houlihan Lokey 36
I Iberdrola (IBDRY) 74, 84
IDC Health Insights 88
IMS Health (RX) 78
Inditex 74
ING Clarion Real Estate 42
Integrity Research 80
Intel (INTC) 6, 88
IPC 58
IvyExec 48
J Johnson & Johnson (JNJ) 6
JPMorgan Chase (JPM) 58, 83
K KeyOn Communications 80
KFC (YUM) 58
Korea Gas 32
Korn/Ferry (KFY) 72
Kraft (KFT) 58
L Liberum Research 72
Lloyds Banking (LYG) 6
M Mango 74
Mattel (MAT) 27
McDonald's (MCD) 27, 58, 93
Merrill Lynch (BAC) 42, 87
MetLife (MET) 15
Mia Group 42
Microsoft (MSFT) 27, 42, 70, 93, 97
MMB 58
Monster.com (MWW) 27
Motorola (MOT) 100
N New Alternatives (NALFX) 84
Nintendo (NTDOY) 88
Nokia (NOK) 40
NPD Group 58
O Occidental (OXY) 32
Opel 6
Open Text (OTEX) 93
Oracle (ORCL) 93
OSI Restaurant Partners 72
P PepsiCo (PEP) 72
PFC Energy 32
Pfizer (PFE) 40
Pioneer Asia 74
Posit Science 88
PwC 76
R Raymond James (RJF) 93
RBS (RBS) 6
Real Estate Analytics 42
Real Estate Research 42
Realpoint 42
Reis 42
Repsol YPF (REP) 84
RiseSmart 48
Royal Dutch Shell (RDS) 32
Royal Philips (PHG) 88
Russell Reynolds 72
S Sandelman 58
S&P (MHP) 74, 87, 93
Sanford C. Bernstein (AB) 93
Sanofi 78
SAP (SAP) 93
Seligman Investments 93
Sims Metal Management (SGM) 83
Sovereign Bancorp 74
Spherion Staffing (SFN) 27
Starwood (HOT) 70
Sterling Equities 42
Strategas Research 30
Subway 58
T TalentDrive 27
Target (TGT) 27
Tata Group 74
Telefónica (TEF) 74, 84
T.G.I. Friday's 58
TNS Media Intelligence 27, 78
Toyota (TM) 38
Toys "R" Us 27
Txtr 40
U UBS (UBS) 83
UPS (UPS) 73, 93
V Van Eck Global 83
Verilogue 78
Verizon (VZ) 100
Virgin Media (VMED) 83
Vontobel 93
W Wal-Mart (WMT) 27, 58
Walt Disney (DIS) 6, 36
Watson Wyatt (WW) 27
Weiser Realty 42
Wendy's (WEN) 58
Weyerhaeuser (WY) 48
Winslow Green (WGGFX) 83
Wunderlich Securities 83
Y Yahoo! (YHOO) 97
Y Combinator 76
Yellowstone Club 42
YouTube (GOOG) 27, 58, 100

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Business Is Missing in Action

It's time for corporate leaders to unite and work on rescuing the economy

American business has been on the defensive for a decade—tarred by scandals at Enron and WorldCom, excoriated for excessive executive pay, and, most recently, scarred by the perception that government has rescued many financial institutions whose greed and shortsightedness led to the worst economic crisis since the Great Depression.

It shouldn't surprise us that opinion polls show that Americans, and their leaders in Washington, hold U.S. business in low esteem.

Now it's time for business to go on the offensive by playing a leading role in trying to solve the nation's economic problems. Our country faces structural challenges that are undeniable but, politically speaking, untouchable.

For example, we've accumulated a staggering $60 trillion in unfunded government liabilities and promises, principally related to Medicare and Social Security. This burden could destroy the quality of life of future generations. And with our national savings rate low, we're dangerously dependent on foreign lenders. If we don't get our fiscal house in order, these lenders could lose confidence in our economy. That would trigger a true crisis: a plummeting dollar, soaring interest rates, and runaway inflation.

Given what's at stake in this and other challenges, the silence of business leaders is disturbing. (*New York Times* columnist Thomas L. Friedman has called us "MIAs" in the battle to solve national problems.) In my more than 50 years in business, I cannot recall a time when there were so many daunting national challenges, with business engagement so lacking.



This was not always so. In 1942, in the midst of World War II, businessmen like Paul G. Hoffman (president of Studebaker), Bill Benton (of ad agency Benton & Bowles), and Marion B. Folsom (treasurer of Eastman Kodak) formed the nonpartisan Committee for Economic Development, a business-led group of academics and executives. Its members included CEOs of major American companies who were pro-growth and who cared deeply about America's future. They helped prevent a return to economic isolationism and beggar-thy-neighbor trade policies. After the war, the committee (which still exists to study and make recommendations on policy issues) helped establish the Employment Act of 1946, the Council of Economic Advisers, the Bretton Woods institutions (the World Bank and International Monetary Fund), and the Marshall Plan, which famously rebuilt Europe. Studebaker's Hoffman became the plan's first administrator.

Those corporate leaders not only formulated policies but also spearheaded the selling and implementing of them. Many of us forget that at its inception the Marshall Plan had a dismal public approval rating of 14%. That changed after the business community launched an aggressive public education campaign about its importance. As former Yale School of Management Dean Jeffrey E. Garten wrote in *The Politics of Fortune: A New Agenda for Business Leaders* (2002), these men "rose above the interests of any firms or industry and focused instead on the public interest through a pragmatic business lens."

Today we need a private-sector Marshall Plan to rescue our own economy—a vast effort in which business leaders, including CEOs and their boards, organize to be heard on the issues and not just lobby for favors. It's time to create a new nonpartisan organization, a public movement to which business leaders lend their names in order to speak out about our long-term structural problems and their potential solutions.

It's essential, too, that we lead by example. We must readopt the values that animated our leaders—corporate and political—six decades ago. That means any call to sacrifice begins with us. To take just one example: At a time when soaring health-care costs threaten U.S. competitiveness, do we fat cats really think we should get our Cadillac health benefits tax-free?

It's time to get off our butts, cure ourselves of an aggravated case of short term-itis, and create a movement that makes it safe for our politicians to opt for the hard choices and unsafe for them to continue to do nothing—to deny the undeniable and pretend we can sustain the unsustainable.

It's time for business to do the right thing, not just to protect our kids and grandkids but to safeguard our remarkable country's future. |BW|

Former Commerce Secretary Peter G. Peterson is co-founder of The Blackstone Group and founder of the Peter G. Peterson Foundation, a group devoted to solving America's structural fiscal problems.

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